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I. MAIN FINDINGS AND RECOMMENDATIONS

A. Role of the United Nations in the framework of international economic cooperation

1. In recent years dramatic political events and the cumulative effect of economic and technological processes have reshaped the world economy, added new issues to the agenda of the international community, and enhanced the potential role of the United Nations in the economic and social area as well as in the political arena. The questions that arise are how can Governments utilize the United Nations to pursue their common interests in these new conditions, and how can they more effectively than before meet the twin challenge of development and eradication of world poverty?

2. The United Nations system is in need of reform. Its specialized agencies are autonomous bodies with their own financial arrangements and governing councils. Their activities are largely operational but also include the drawing up of sectoral strategies and plans of action and assisting Governments in setting national goals and targets. They also have the lead role in financial and technical assistance. The big organizations are to a great extent self-contained, and in spite of their sectoral mandates their activities frequently overlap, resulting often in spontaneous cooperation but sometimes in conflict. The United Nations itself is different in many respects from its specialized agencies. It revolves around the Security Council, the General Assembly and the Economic and Social Council, but its structure is complicated and lacking in transparency. In spite of its weaknesses, however, the United Nations has in the past played a unique role in the economic and social fields. It has not only been an important source of ideas for international cooperation and the raising of new major issues, but it has also been a place in which all countries may raise virtually any issue of concern to them. This is particularly valuable to countries lacking influence and access to world attention. The role of the United Nations Secretariat has been primarily to support the deliberative work of the intergovernmental bodies through research and analysis.

3. Coordination of the activities of the specialized agencies could be improved by flexible cooperation among agencies whose spheres of interest intersect; efforts by Member States to take more consistent positions in the various governing councils of which they are members; revitalization of the Economic and Social Council so as to enhance its overview function. The complicated structure of the United Nations itself needs to be made more rational and transparent. Greater coordination between the Council and the General Assembly is also important, and their respective agendas need to be streamlined and made more relevant. In the recent administrative reorganization of the United Nations Secretariat, there have been disturbing signals of a possible reduction of its research functions in the economic and social fields. This function, on the contrary, needs to be strengthened, especially since it is only within the principal organs of the United Nations that socio-economic issues can be analysed in their political context.

B. World economic outlook, 1992-2000

4. The short-term outlook for the world economy remains fragile. In the industrial market economies, growth remains sluggish and unemployment high. The recovery is expected to be slow and uncertain, suggesting the need for temporary fiscal stimulus in some major developed market economies. Among the developing countries, GDP growth patterns are widely divergent and domestic policy reforms continue to be the principal determinant of growth, but generally growth is constrained by the recession in the industrial market economies. In the Eastern and Central European countries, output continues to contract and unemployment to rise and economic problems loom much larger.

5. The medium-term outlook inspires cautious optimism. In the industrial market economies, with careful management, the 1990s could see a return of a growth rate of GDP of some 3 per cent a year and a real average growth rate of trade of some 5-6 per cent a year. Such trends would permit adjustments in production structures of goods and services making room for suppliers from the rest of the world. Under such assumptions, recent projections of medium-term growth in developing countries look brighter. GDP growth rates in developing countries are expected to pick up generally but remain divergent, with the Asian countries doing better than the Latin American and African countries. The prospects for a number of small, very poor countries, including most of the least developed countries, however, are less bright. These countries are expected to lag behind the others. For the Eastern and Central European countries, the medium-term prospects range from modest optimism to gloom.

6. The major factors underlying the medium-term outlook in the industrial countries are the policy reforms of the 1980s, completion of the European Community single market programme and the creation of the European Economic Area, the establishment of a North American free trade area, and continuing rapid technical progress, making for rising economies of scale, greater competitiveness and increasing productivity. For other countries to benefit in the process, it is important that neither a "fortress Europe" nor a "fortress America" emerges. Growth prospects world-wide would be undermined, however, if the Uruguay Round should fail. Reduction of military expenditures constitutes a potential source of accelerated global growth, but its significance is likely to be felt only in the longer term. Acceleration of growth in the developing countries will depend on the performance of the industrial countries and their own continuing domestic policy reforms generally aimed at an appropriate degree of macroeconomic stability and outward-oriented trade regimes. Privileged access of the Central and Eastern European countries to the markets of Western Europe could harm the trade prospects of developing countries. In the international capital markets, the danger persists that some groups of countries will be "crowded out" by the newly industrializing economies and the Central and Eastern European countries. Rising pressure on global savings will raise interest rates and the cost of capital. Thus, a medium-term policy objective of developed market economies should be to raise national savings rates, mainly by reducing fiscal deficits and easing the stance of monetary policy. For developing countries, dependent on official development assistance (ODA) for the bulk of their development finance, the poor prospects for growth in ODA are particularly serious in view of the likelihood of a diversion of existing ODA levels to the countries with economies in transition.

C. Environment, development and poverty

7. Historical patterns of economic development have caused the stock of natural capital to contract considerably and often to become degraded. In addition there has been a rapid loss of biodiversity partly because of deforestation in countries with temperate climates. Recently, there has also emerged a serious threat to global warming.

8. All environmental problems - all apparent conflicts between development and the protection of the environment - arise either from:

(a) Governmental failure - i.e., incentives created by Governments to use the environment wastefully and inefficiently;

(b) Market failure - i.e., failure of prices generated by the market mechanism to reflect fully the costs of production and consumption;

(c) Missing markets - i.e., absence of or unenforced property rights for environmental services and therefore a lack of vested interest on the part of economic agents in the sustainable exploitation of natural resources;

(d) A situation in which the income-earning opportunities to which the poor have access are insufficient to sustain life without depleting the stock of natural capital.

9. Sustainable development requires policy reforms in all societies to correct for past errors in the management of natural resources and fragile ecological systems. There is no conflict between development and the reduction of poverty, on the one hand, and the maintenance of the stocks of natural capital at viable levels, on the other hand, which cannot be resolved through changes in policies, incentives and institutions. Wherever government failure exists, inappropriate policy incentives, such as subsidized cost of water, land, resettlement schemes in fragile lands, logging activities etc. need to be eliminated. Market failure calls for government intervention to correct market prices or to strengthen regulatory frameworks so that producers and consumers respond to a set of incentives that accurately reflects all costs. Where markets are missing, the primary solution is to correct the incentive system through the creation of enforceable property rights, either individual, collective, state or supranational. Underlying all economic mechanisms that would create the right incentives is the "polluter pays" principle which applies not only to air and water pollution but also to the degradation and depletion of other resources. In many areas, however, it is admittedly difficult to determine the ideal or optimal set of incentives, or the correct prices.

10. With regard to poverty alleviation, questions of equity are involved which also need to be addressed. The alleviation of poverty calls for greater access by the poor to resources and employment and adequate investments in human development so as to reduce the concentration of the poor on marginal land and thus prevent problems of land degradation by the poor. Application of the "polluter pays" principle should not be allowed to impoverish the poor further. In many cases, subsidized use of natural resources by the poor, such as clean water and sanitation, results in considerable positive externalities in terms of health and productivity and is fully justifiable.

11. In cases where economic activity generates negative externalities at the global level, such as global warming, a uniform global tax could be imposed on emissions generated by the burning of fossil fuels following the "polluter pays" principle. The burden of such a tax would fall most heavily on the industrial countries that are the heaviest polluters. Another possibility would be to issue nationally and internationally traded emission permits. If such a scheme were introduced internationally, the initial distribution of emission permits could be skewed towards the developing countries, thereby ensuring that revenues raised by the scheme accrued disproportionately to them, the major losers from past misuse of the global commons. Alternatively, lesser polluting technologies could be transferred to developing countries at zero cost or heavily subsidized costs as payment for services rendered in terms of reduced global emissions.

12. Since the developed countries are the principle polluters, they have an obligation to bear their share of the cost of reducing environmental damage. Whatever funding is needed to improve the global environment should be based on the "polluter pays" principle and should not be confused with traditional development aid. A number of innovative approaches to funding environmental activities has been proposed - for instance, a carbon tax and tradeable permits, mentioned above, debt relief, charges for the use of the global commons - seabed resources, ocean fishing, use of the high seas by shipping, use of the atmosphere for air transport - which could yield substantial revenues. A facility could be established for compensating developing countries for the opportunity costs of preserving tropical forests and, thereby, providing environmental services - habitats for biodiversity and carbon sinks - to the international community.

D. Economic reforms in developing countries

13. In the 1980s, economic policy in a large number of developing countries was dominated by macroeconomic problems of external and domestic balance and by the constraints arising from stabilization and adjustment programmes put in place to cope with those problems. This preoccupation has continued into the 1990s. As a result of a sequence of negative external shocks, starting with the first oil shock of the early 1970s to the collapse of international bank lending in the early 1980s and the persistent decline in commodity prices, it became evident that developing countries faced an extremely adverse external environment and needed major structural adjustments which could not be achieved by the traditional short-term stabilization programmes of the International Monetary Fund (IMF).

14. From that realization emerged the so-called "Washington consensus", an IMF/World Bank policy package combining stabilization and medium-term structural adjustment measures which are embodied in five principles: budget balancing, relative price correction, trade and foreign investment liberalization, privatization, and domestic market liberalization.

15. The adoption of the new expanded agenda by the developing countries has been widespread, but there are significant differences among regions and among countries within the regions, both as to the objectives and scope of reforms as well as in the impact of similar measures. The report discusses extensively what seem to be the causes of relatively greater or lesser degrees

of success and the short-term consequences of the programmes in such areas as investment in physical capital and infrastructure, human resources development and the incidence of poverty.

16. It has been increasingly realized that for structural adjustment packages to be sustainable and conducive to longer-term growth, they must include measures to cope with transitory social costs that often cause the reform programmes to be abandoned and to ensure satisfactory levels of investment in physical infrastructure and human resource development. Experience with structural adjustments also indicates that in many developing countries a variety of fundamental structural and institutional changes are needed to ensure growth. For instance, many developing countries need not only budget balancing but broad fiscal reforms, including foreign and domestic debt restructuring, elimination of rent-seeking entitlements, closure or privatization of inefficient state enterprises and adoption of more adequate tax systems. Furthermore, structural adjustment programmes which do not explicitly incorporate measures which address long-term development goals - alleviation of poverty, improvement in the distribution of income, and the socio-economic attainments of women - are likely to fail since a broad-based consensus in support of reform is unlikely to become firmly established.

17. In many developing countries, economic reforms and economic development are made impracticable by an unfavourable political process and mode of governance. There are countries where there is a lack of transparency in government decision-making, a lack of government accountability to the populace, and the denial of fundamental human rights to large segments of population. Such situations are attributable to vested interest groups wielding economic and political power, averse to social change and broad-based economic progress for fear that their own particular interests would be undermined.

18. Failure to embark upon a comprehensive reform programme to address both issues of short-term stabilization and medium-term growth-oriented structural reform is likely to result in failure and a premature abandonment of the programme. Within a framework of macroeconomic stability which only the State can provide, most decision-making in economic matters should be decentralized as much as possible, consistent with the country's basic socio-economic objectives. This will require measures in the whole range of policy areas, including fiscal, trade, exchange rates, industrial, labour, social and others. There is, moreover, the question of speed, intensity and sequencing of reforms.

19. In the area of fiscal policies, public-sector investments and social spending should be rationalized so as to sustain adequate levels of investment in infrastructure, agriculture, and energy and to increase access of the poor to health, education, and adequate nutrition. In times of retrenchment of public expenditure, offsets to these priority expenditures should come from the phased reduction of subsidies. Food subsidies would need to be reduced and targeted towards groups not protected from inflation or income loss from unemployment. Effective implementation of targeted programmes may need improved collection of socio-economic data to permit the monitoring of the impacts of reforms. Public sector enterprises should be required to follow

market rules that reward profit and punish inefficiency. Selective privatization may follow where it would appear likely quickly to increase efficiency.

20. Further revenue for growth-enhancing expenditures can come by freezing the level of defence expenditures and then programming phased reductions in their levels over the medium term. Pricing policies for public services such as power, water for irrigation, and higher education should also be adjusted to the user's ability to pay. In many countries tax bases need to be widened and strengthened. In general, this would mean income tax reform by eliminating exemptions, plugging loopholes and improving tax enforcement. It could also mean phasing in a value-added tax and reducing what may be considered excessively high marginal income tax rates. Fiscal reform, if carefully designed and vigorously implemented, will enable countries implementing reforms to provide an adequate safety net for vulnerable groups and to maintain or even increase expenditures on human resource development.

21. Besides overhauling its fiscal system, the State can contribute more effectively to economic development by modifying its approach to development, from one involving heavy governmental intervention and regulation to a more indicative approach. None the less, a government's capacity to both develop policy and administer it must improve if reform is to succeed.

22. In the area of trade and exchange-rate policies, reforms should include replacing non-tariff barriers by tariffs and reducing gross disparities among tariff rates, then progressively lowering the tariff structure to encourage efficiency and to eliminate anti-export bias. Changes in the exchange rate may be needed to create a favourable climate for exporters. The preferred exchange-rate regime for developing countries with rapid inflation would seem to be "dirty floating" or a crawling peg, maintained by controls differentiating between capital inflows and outflows and between long-term and short-term capital movements. In this context measures which discourage foreign direct investment or the repatriation of flight capital should be reviewed and most of them eliminated.

23. Industrial and labour policies should be reviewed and reformed. Adequate employment termination benefits and job retraining programmes should replace efforts to preserve employment by keeping loss-making enterprises afloat through public subsidies. Small industries could in some circumstances receive some support through fiscal measures and access to credit, but such measures should be time-bound.

24. Measures to provide effective and affordable family planning services are, of course, highly complementary to any programme aimed at reducing gender bias. They are also closely related to longer-term solutions of certain environmental problems and of rural poverty. Governments can improve the supply response of small private sector enterprises in both rural and urban settings by taking strong measures to eliminate gender bias in land tenure, customary use rights, property titles and access to credit and community services.

25. Although there may be regional variations, the experiences of many reforming countries show that the growth and welfare benefits of comprehensive reform programmes are realized only after a considerable period of time.

Sometimes, as in several African countries, this is as much as a decade or more. In order not to succumb to "adjustment fatigue", many countries may need to pursue political reforms which, among other things, will foster a greater sense of participation in decision-making at the grass-roots level. Improvements are also needed in basic elements of governance so that States will become effective agents of development: adherence to the rule of law, transparency in the use of public funds, and accountability to the governed.

26. The success of developing countries implementing reform programmes will depend on their own efforts but will clearly be enhanced with a favourable external environment providing them with a growing market for their exports and access to adequate external finance on appropriate terms and conditions. Donor countries can assist reform efforts by encouraging developing countries to programme measures and establish performance targets over a long-term horizon. Donors should then support such programmes with a multi-year financial commitment. Annual performance reviews could establish a basis for flexibility as to the intensity of policy measures appropriate in the light of changes in the external environment. This, in turn, would require flexibility as to the annual amounts, timing and terms of external financial support so as to lead towards stabilizing the import capacity of reforming countries. Donors should recognize that countries simultaneously implementing political and economic reforms will justify higher levels of support over a longer time-frame than in the absence of political reform. Their support, while conditional on the continuation of reforms in both the political and economic spheres, should explicitly take into account these enhanced financial requirements. Although it is important that donors do not impose any particular political or economic model on aid-receiving countries, there is a continuing need to refine the methodology and the collection of appropriate data to measure the human rights impact of economic and political change.

II. ROLE OF THE UNITED NATIONS IN THE FRAMEWORK OF INTERNATIONAL ECONOMIC COOPERATION

A. Need for review

27. The activities of the United Nations system in the economic and social fields are far flung and varied. Many of them have long since become self-evident - the control of epidemics, the regulation of navigation on the seas and in the air, the allocation of radio frequencies, the cooperation in meteorological forecasting ...; the list could be very long. The benefits of this kind of international cooperation are so great that it is questioned by no one.

28. When the role of the United Nations in the economic and social fields is nevertheless in need of clarification, this refers primarily to the contribution of the system to development and poverty alleviation in developing countries. This absorbs the great bulk of the resources allotted to multilateral international economic cooperation by the Governments who finance most of it. These Governments, including many that subscribe to the objectives of multilateral development assistance, have for many years voiced greater or lesser dissatisfaction with the United Nations work. The complexity of the system is found to be frustrating, and its fragmentation and bureaucratization are suspected of making its contribution to development ineffective and wasteful. Developing countries, too, however much they value the United Nations, complain about the lack of coordination.

29. In the recent decade, dramatic events and processes have made the world very different but also potentially more favourable from that in which the United Nations was born and evolved its agenda:

(a) The end of the Cold War and the East/West arms race, and the break-up of the Soviet Union;

(b) A tentative convergence in fundamental approaches to economic organization;

(c) An intensification of international flows of goods, money, ideas, and people, based on new technologies of communication;

(d) Consequently, an erosion of the powers of individual Governments to control such flows, and manage their own economies;

(e) The emergence of new concerns of universal scope.

The role of the United Nations in this new world ought to be more important than ever. The questions that arise are how can Governments pursue their common interests through the United Nations in these new conditions, and how can they more effectively than before meet the twin challenge of development and eradication of world poverty which remains the inescapable commitment of the United Nations in its search for lasting peace?

B. United Nations system

30. The number of agencies and bodies in the United Nations system is around 150. In some contexts, though not in others, it is taken to include IMF, the World Bank, and the General Agreement on Tariffs and Trade (GATT). Their activities are largely operational but also include drawing up sectoral strategies and plans of action and assisting Governments in setting national goals and targets, as in health and education and other sectoral policies. Although there is also extensive bilateral financial and technical assistance, the agencies tend to have a leading role, and the World Bank and United Nations Development Programme (UNDP) have key responsibilities in the difficult struggle to coordinate multilateral and bilateral assistance on the country level.

31. The specialized agencies have deliberately been created as autonomous bodies with their own financial arrangements and governing councils. The big organizations are to a large extent self-contained, and in spite of their sectoral mandates their activities frequently overlap, reflecting the interdependence of their fields of primary responsibility. A certain amount of competition among the agencies is no doubt healthy. Sometimes there is also spontaneous cooperation in research and joint projects. At other times, however, there are conflicts and clashes.

32. Above all there is lack of clarity. Member States acting in different governing councils endorse or condone the overlap in activities, but in their capacities as donors and financial contributors they find the system incoherent. Many suggestions have been made to set up new bodies to supervise the allocation of resources - the latest one being the so-called Nordic proposal for common governance of funding bodies. These ideas deserve careful study.

33. Whether new formal arrangements are resorted to or not, three paths should be encouraged:

(a) Flexible cooperation among agencies whose spheres of interest intersect;

(b) Greater effort by Member States to take more consistent positions in the various governing councils of which they are members;

(c) Revitalization of the Economic and Social Council so as to enhance its overview function.

C. United Nations itself

34. The United Nations is in many respects different from the specialized agencies, and its role in economic and social affairs is less obvious. Even the boundaries of the United Nations are obscure, with some bodies under the regular budget and others not, and with boards and governing councils whose authority crisscrosses that of the Secretary-General and the General Assembly. Governments are right to complain about its byzantine structure; they made it that way, and they should make it more rational and transparent. Some operational activities such as technical assistance take place under the

United Nations aegis, and what applies to the rest of the system applies also to them.

35. But the United Nations revolves essentially around the Security Council, the General Assembly, and the Economic and Social Council. In the economic and social fields, the Charter allocates responsibilities both to the Council and the General Assembly, but the system has not been coordinated as the Charter vaguely anticipated. The United Nations Conference on Trade and Development (UNCTAD) has played a complementary role in its special domains of trade and development.

36. But an overview of the work of the system and of the world situation is needed. The issues dealt with by sectoral agencies are interdependent - increasingly so. They are the preoccupations of sectoral ministries in Member States, but these need to be balanced and placed in a political context. Similarly, the deliberations in the United Nations should be based on an integrated governmental approach. This they tend to be in the general debates of the General Assembly, at which heads of states and prime ministers are the principal speakers, but this perspective tends to get lost in subsequent work. The overview function of the Economic and Social Council should serve this purpose, and the recent reform of the Council's working procedures should go some way towards making this possible.

37. For all the weaknesses of its procedures, the United Nations has in the past had other essential roles in the economic and social field. It has been a place in which all countries may raise virtually any issue of concern to them. This has been particularly valuable to countries lacking in influence and access to world attention. It contributed greatly to the United Nations first major challenge of helping the world through the turbulent period of decolonization. It has also been an irritant to bigger countries, and the profusion of resolutions in arcane language is a source of puzzlement to the public and the communications media. The practices need streamlining. The agenda has become repetitive, some of it irrelevant, and needs complete overhaul. But the United Nations function as a forum for the world has to be preserved.

38. Over the years the United Nations has been an important source of ideas for international cooperation and has brought new issues to world attention. These have in many cases come to be so taken for granted that it is forgotten what an important role the United Nations played by, for instance, calling major conferences on population, environment, and the role of women in development.

39. The role of the Secretariat of the United Nations itself is primarily to support the deliberative work of the intergovernmental bodies by research and analysis. It is also responsible for the collection and preparation of global statistics and data banks, a natural responsibility of a world organization. The Secretariat too needs review and improvement. In the present administrative reorganization of the Secretariat there have been disturbing signals of reduction of the research function in the economic and social field. It should instead be strengthened, with special attention to its links with the outside research community, which are vital for the generation of new ideas.

40. A special reason for emphasizing the role of the United Nations in the economic and social field is that only there can political and socio-economic issues be merged. This has not been common in the past, as decades of East/West confrontation in the Security Council and North/South confrontation in the General Assembly created a cleavage between the political and economic sides of the United Nations. In the Secretariat and in delegations, the two sets of issues were dealt with in isolation one from the other. In recent years, however, economic and social issues have risen to the top of political agendas everywhere, and this has been reflected in the general debates at the United Nations.

41. The world community faces new and serious political issues which call for international economic cooperation. The United Nations Conference on Environment and Development is one example; it may well conclude that special arrangements will have to be made for the monitoring of sustainable development. The alarming international drug trafficking links poverty in rich countries with poverty in poor countries. The pressure of international migration threatens to become a source of serious conflict. Both are also reminders that Governments cannot by themselves contend with powerful economic forces and that meaningful joint approaches must be sought.

42. Brief discussions in the Economic and Social Council or elsewhere can only be a beginning to the reforms that are necessary in the international system and in the work of the United Nations. But the time seems right to set in motion changes which have long been blocked by bureaucratic inertia and political stalemate.

III. WORLD ECONOMIC OUTLOOK, 1992-2000

43. The United States and other leading industrial market economies which have been in recession for some time only now appear to be recovering, while growth in others has recently begun to slow. Thus, the short-term outlook for the global economy is still fragile, although there are some hopeful signs. With careful management, the 1990s could see a return to growth rates of some 3 per cent a year for the industrial market economies. The accompanying annual world trade growth could return to 5-6 per cent. Such performance would provide a strong base for global growth. Risks of a more protracted slow-down, however, persist.

44. Some of the leading developing economies in Asia have cut back growth to deal with their inflation and other "overheating" problems, but they are still growing at 6 per cent or more. In contrast to the early 1980s, moreover, quite a few other developing countries, across regions, are benefiting from greatly improved policy environments and experiencing accelerated growth. Some developing countries, notably some of the poorest, are, however, still stagnating. In the most acute cases, per capita incomes are still falling. In Central and Eastern Europe most countries are now "in transition" at widely varying paces of change and economic performance. A balanced overview must take the progress that has been, and is, taking place into account. But this does not mean that all is well with the world. Many old problems remain to be resolved, such as high unemployment, increased poverty, and income inequality, and new ones are emerging.

A. Short-term outlook, 1992-1993 1/

45. Last year's expectations of an early lift in the recessions in several industrial market economies have not yet been fulfilled. Although the industrial market economies escaped relatively unscathed from the war in the Middle East, as noted last year, 2/ performance in the United States of America and Canada, Germany, Japan, the United Kingdom of Great Britain and Northern Ireland, Australia and New Zealand, has, for a variety of reasons, been sluggish. The expected recovery in demand in the United States and Canada, in particular, has not materialized and is now not expected to do so until the second half of 1992. Financial market disarray is clearly a new problem. The mini boom created in Germany in restructuring in the eastern half of the country has been replaced by the effects of unemployment growth in the eastern part of the country, and this has placed a considerable burden on the economy as a whole. A different mix of fiscal and monetary policies might have to be used to avoid serious recession. Hopefully, a turn around will be evident in Germany by the second half of the year or early in 1993. The set-backs created in Japan by financial market shocks have not yet been overcome. Attempts to shift from exports to domestic spending have not yet been successful. The other recession-affected economies are also still waiting for recovery. Insufficient attention is being paid to rising unemployment in industrial market economies. Most are reluctant to take policy initiatives to tackle unemployment for fear of inflation. Although the recession that has opened the 1990s parallels the early 1980s recession in many respects, some industrial market economies have been less affected than in the early 1980s. But unemployment, already high by standards since the

Second World War, has risen in the recession-affected countries and also in France. Following the early 1980s experience, employment is also expected to improve more slowly than other economic indicators (table 1).

Table 1. Unemployment rates in developed market economies

	1991	1992	1993	1995	2000
Developed market economies	7.2	7.8	7.5	6.9	6.5
North America	7.1	7.6	7.0	5.9	4.7
Developed East	3.0	3.6	3.4	3.7	3.9
Western Europe	9.7	10.3	10.3	9.9	10.0
European Community	9.6	10.1	10.1	9.7	9.8
Other Western Europe	9.9	12.7	12.7	11.3	11.3

Source: United Nations, Department of Economic and Social Development, "Project Link world outlook" (10 April 1992). Mimeo.

46. Overall, the expectation of recovery suggested by last year's short-term projections must be moderated somewhat, but rising output and trade are expected by the end of 1992 and into 1993. The recovery is, however, expected to be slower than was the case in earlier recessions.

47. The recession and slow recovery in the industrial market economies are unhelpful to developing countries and to those in the eastern part of Europe. In both, of course, domestic policies continue to be the principal determinants of economic performance, but a more buoyant international environment would make growth easier for all. In all of the Eastern European countries output continues to contract and unemployment continues to rise. Such trends are evident even in Hungary, Czechoslovakia and Poland, where structural change is taking place in an environment of macroeconomic stabilization. Inflation is being brought under control. Balance-of-payments indicators are modestly sturdy. Trade with European market economies is growing and policy and institutional changes are establishing the basis for further market-oriented development. Provided the standard-of-living declines common in restructuring do not continue too long, and if the industrial market economies and international organizations can provide adequate and appropriate assistance, these three countries' long-term economic prospects are positive. For the other countries in Central and Eastern Europe economic problems loom much larger for the short and medium term. They will require major domestic policy initiatives and considerable international support through 1992 and 1993 and later into the 1990s if they are to overcome the problems of transition.

48. The widely divergent patterns of growth among developing countries, noted by the Committee last year, are again evident (tables 2 and 3). Developing countries are showing considerable divergence from the industrial market economies. This reflects the considerable improvement in the policies of a number of them (discussed in chap. V of this report). Domestic policy reform

has been stressed as a key input into economic performance by this Committee for several years. Recent trends in developing countries justify this emphasis. Developments in China and India, with no less than two fifths of the world's population, are among the most important. The Chinese economy in coastal areas, particularly in the south, is booming, with a continuing expansion of exports. With the success of its stabilization policies, China returned to the theme of economic reform in late 1991. India is undertaking the most comprehensive liberalization programme that it has ever initiated. While progress is difficult, it is being pushed forward strongly.

49. In a number of other developing countries across all regions, countries are overcoming some of the major macro- and micro-economic difficulties with new policy initiatives, becoming more stable and at the same time more internationally competitive. In Latin America, more countries experienced increases in their GDP growth rates in 1991 than in the previous year and there was an increase in the number of countries succeeding with their domestic stabilization efforts. Among the larger or medium-size countries, growth was strong in Argentina, Mexico, Chile and Venezuela, and growth began to resume in a few countries which had been mired in recession. In Africa, the 20 "core" countries participating in the Special Programme of Assistance for debt-distressed low-income countries in sub-Saharan Africa (SPA) achieved somewhat higher GDP growth rates than in the 1980s. For some, per capita income growth became positive for the first time in many years despite high population growth. It must, of course, be noted that some developing countries, particularly the poorest and least developed, are yet to be affected. High population growth rates exacerbate their economic problems. But the overall effect, despite the fall in demand in the industrial market economies and correspondingly weak trade growth, has been to raise the performance of some developing countries well above that of the industrial market economies.

Table 2. World gross national product (1988 United States $)

(Percentage change)

	1991	1992	1993	1994	1995	1996-2000
World total	-0.4	1.4	3.1	3.2	3.3	3.3
Developed market economies	0.7	1.8	3.3	3.0	3.0	2.8
North America	-0.8	1.8	3.6	3.0	3.0	3.1
United States	-0.8	1.6	3.5	2.9	2.8	3.0
Developed East	4.0	2.0	3.7	3.3	3.3	2.8
Japan	4.6	1.9	3.9	3.3	3.4	2.8
European Community	0.3	1.9	2.7	2.6	2.9	2.6
Germany	0.0	2.5	3.2	2.3	2.7	2.5
France	0.8	1.6	2.5	2.8	2.6	2.8
United Kingdom	-2.4	1.2	2.5	2.6	2.9	2.6
Rest of industrialized	-0.5	1.0	2.4	3.2	3.2	2.5
Developing countries	2.9	4.7	5.5	5.8	5.6	5.3
Latin American, Caribbean	2.8	3.4	4.1	4.7	4.6	4.2
Argentina	3.0	4.9	4.0	3.4	3.0	3.0
Brazil	1.1	2.2	4.0	5.4	5.5	4.5
Mexico	4.0	4.6	5.2	6.1	5.7	4.9
Venezuela	9.2	3.2	3.8	2.5	2.8	4.1
Africa	1.4	2.8	3.4	3.9	3.8	4.0
North Africa	1.7	3.6	3.8	4.5	4.3	4.4
Algeria	-2.3	1.9	2.9	2.7	4.0	5.4
Egypt	3.3	4.1	4.6	4.9	5.0	4.9
Sub-Saharan Africa	1.0	2.1	3.0	3.3	3.3	3.5
Nigeria	4.4	2.3	3.0	3.2	3.1	3.5
South, East Asia	5.6	6.0	6.6	6.5	6.5	6.3
Hong Kong	4.4	5.2	5.6	5.8	5.7	5.4
India	2.9	4.5	5.3	5.1	5.1	5.0
Indonesia	5.9	6.3	7.1	6.5	7.2	7.4
Republic of Korea	8.3	7.3	8.0	8.5	8.3	7.7
Taiwan Province	7.1	7.3	7.5	7.1	7.0	6.6
Thailand	7.6	8.6	8.4	8.6	8.1	7.7
China	7.0	7.2	6.9	7.0	7.0	7.0
West Asia	-9.7	5.1	7.4	8.2	6.2	3.9
Oil exporters	-11.5	5.6	8.3	9.2	6.8	4.0
Oil importers	2.0	1.7	2.2	2.4	2.4	2.9
Mediterranean	-8.4	1.0	8.1	6.9	6.5	5.5
Eastern Europe 5 a/	-12.4	-2.8	2.2	3.2	4.1	4.5
Commonwealth of Independent States (CIS)	-17.2	-10.9	-6.3	-2.7	-0.3	3.6

Table 2 (continued)

	1991	1992	1993	1994	1995	1996-2000
Memo:						
Western Germany	3.1	1.7	2.4	1.6	1.7	1.9
Eastern Germany	-18.8	8.8	8.8	7.4	9.3	5.9
Eastern Europe and CIS	-16.6	-10.0	-5.2	-1.9	0.3	3.7
Developing countries (excl. China)	2.4	4.3	5.3	5.6	5.4	5.1
Least developed	1.9	3.3	3.6	3.6	3.6	3.5
Net energy exporters	3.0	5.3	5.8	6.1	5.8	5.6
Net energy importers	2.8	4.3	5.4	5.6	5.5	5.2

Source: United Nations Secretariat, Department of Economic and Social Development, Project Link forecast, 10 April 1992.

Note: Principal assumptions are:

Developed market economies maintain anti-inflationary monetary policies, fiscal policies geared to deficit reduction, negligible growth in real aid flows to developing countries but some growth in real aid flows to countries with economies in transition.

Developing countries and those in Central and Eastern Europe continue to implement reforms, and supply responses are large enough to yield results in the medium-term.

The Uruguay Round is expected to succeed.

Oil prices are assumed to be about $15 per barrel in 1992 and 1993, but to increase by 3-4 per cent per year afterwards.

Non-oil commodity prices are assumed to keep pace with world inflation but to improve little, if at all, in real terms.

a/ Bulgaria, Czechoslovakia, Hungary, Poland, Romania.

Table 3. Per capita world gross national product
(1988 United States $)

(Percentage change)

	1991	1992	1993	1994	1995	1996-2000
World total	-2.0	-0.1	1.5	1.6	1.7	1.7
Developed market economies	0.2	1.2	2.7	2.4	2.4	2.2
North America	-1.6	1.0	2.8	2.2	2.1	2.2
United States	-1.6	0.8	2.6	2.1	2.0	2.2
Developed East	3.4	1.4	3.2	2.7	2.7	2.2
Japan	4.1	1.5	3.4	2.8	2.9	2.3
European Community	0.1	1.7	2.5	2.4	2.6	2.4
Germany	0.1	2.6	3.2	2.4	2.8	2.6
France	0.5	1.3	2.2	2.5	2.3	2.4
United Kingdom	-2.4	1.1	2.5	2.5	2.8	2.6
Rest of industrialized	-1.8	-0.3	1.0	1.7	1.7	1.0
Developing countries	1.0	2.7	3.6	3.8	3.7	3.4
Latin American, Caribbean	0.7	1.4	2.1	2.6	2.5	2.1
Argentina	1.6	3.5	2.7	2.1	1.7	1.7
Brazil	-0.7	0.4	2.1	3.5	3.6	2.6
Mexico	1.8	2.3	2.9	3.9	3.4	2.7
Venezuela	6.6	0.8	1.4	0.1	0.4	1.7
Africa	-1.7	-0.2	0.3	0.8	0.7	0.9
North Africa	-0.6	1.2	1.5	2.2	1.9	2.1
Algeria	-5.2	-1.1	-0.1	-0.3	0.9	2.4
Egypt	1.2	2.0	2.5	2.8	2.9	2.8
Sub-Saharan Africa	-2.1	-1.1	-0.3	0.0	0.0	0.2
Nigeria	0.8	-1.3	-0.6	-0.4	-0.5	-0.1
South, East Asia	3.7	4.1	4.6	4.6	4.6	4.4
Hong Kong	3.0	3.7	4.2	4.4	4.3	4.0
India	1.2	2.9	3.6	3.4	3.4	3.3
Indonesia	4.2	4.6	5.3	4.8	5.4	5.7
Republic of Korea	6.8	5.8	6.5	7.0	6.8	6.2
Taiwan Province	5.8	6.0	6.2	5.8	5.7	5.4
Thailand	5.8	6.8	6.6	6.8	6.3	5.9
China	5.8	6.0	5.7	5.8	5.8	5.8
West Asia	-12.3	2.0	4.3	5.1	3.1	0.9
Oil exporters	-14.0	2.7	5.3	6.1	3.8	1.1
Oil importers	1.3	-1.6	-1.1	-1.0	-1.0	-0.5
Mediterranean	-9.7	-0.4	6.5	5.4	5.0	4.0
Eastern Europe 5 a/	-12.8	-3.3	1.7	2.7	3.6	3.9
Commonwealth of Independent States (CIS)	-17.8	-11.6	-7.0	-3.5	-1.1	2.8

Table 3 (continued)

	1991	1992	1993	1994	1995	1996-2000
Memo:						
Western Germany	3.2	1.9	2.5	1.7	1.8	2.0
Eastern Germany	-18.9	8.6	8.7	7.2	9.1	5.8
Eastern Europe and CIS	-17.2	-10.6	-5.9	-2.6	-0.4	3.0
Developing countries (excl. China)	0.2	2.1	3.1	3.4	3.2	2.9
Least developed	-1.0	0.3	0.6	0.6	0.6	0.5
Net energy exporters	1.4	3.6	4.1	4.4	4.1	3.9
Net energy importers	0.7	2.2	3.2	3.4	3.3	3.0

Source: United Nations Secretariat, Department of Economic and Social Development, Project Link forecast, 10 April 1992.

a/ Bulgaria, Czechoslovakia, Hungary, Poland, Romania.

B. Policy concerns

50. Low commodity prices and industrial market economy sluggishness are reflected in low inflation in most key industrial economies. It remains, however, an important policy concern. Germany persists with a tough monetary policy for this reason, but in the United States, concern has shifted to the sluggishness of the recovery. International inflation as measured by world export prices is likely to remain about 2 per cent in 1992, perhaps rising to 3 per cent or more in 1993. Some countries, including developing ones, will continue to improve on inflation rates, while others, both developing and industrial, are likely to continue to have macroeconomic policy difficulties which will be reflected in high inflation.

51. Price stability and the prudent monetary policies which contribute to it, are likely to maintain reasonable exchange rate stability. Interest rates also seem likely to be stable, albeit remaining relatively high by historical standards, at around 4 per cent in real terms.

52. Although the scope for active monetary and fiscal policy may be more limited than was once thought, there is more room for policy initiatives than during a period of high inflation. Infrastructural facilities are ageing in a number of countries because public investment is lagging. This suggests that policy makers should be concerned with easing fiscal policies. Some further easing of monetary policy is also likely to be necessary in the recession-affected economies if conditions have not improved by mid-1992. The package of fiscal and monetary measures implemented in Japan early in the year responds to such needs and opportunities.

53. Excessive policy focus on bilateral trade balances must be defused if the debate concerning them is not to destabilize trade and other multilateral negotiations. Bilateral balance-of-payments intervention for short-term results is counterproductive.

C. Medium term, 1994-2000

54. Cautious optimism continues to underlie most medium-term projections. Such projections, like those discussed in this section, are not really forecasts but are plausible futures based on assumptions about policies and the stability of the historical behaviour of economic agents. They serve mainly to organize discussions and to highlight potential areas of policy concern. Some positive trends are evident: the policy reforms of the 1980s, the market unification effects of the European Community (EC) in 1992, complementary European economic cooperation negotiations and the establishment of a North America free trade area with the potential participation of Mexico, should lead to an easier flow of goods, services, labour and capital, with concomitantly rising economies of scale and greater competitiveness. For such beneficial results to take place, the inward-turning, protectionist possibilities that are also inherent in these regional initiatives will need to be overcome, so that neither fortress Europe nor fortress America will eventuate. Continuing rapid technological change presages rising productivity. Although the outlook for a final conclusion to the Uruguay Round continues to be ambivalent and uncertain, much has already been achieved. The North/South dichotomy that dominated international debates in the past has weakened as attention focuses on world-wide issues. The Cairns Group of primary exporters is an example. There has been progress on many trade issues, not least in services. Although the timetable is very prolonged, progress has also been made on the phasing out of the Multifibre Arrangement, a key market access issue for developing countries. As multilateral trade negotiations proceed, the easier issues are dealt with so that those remaining inevitably become more difficult to resolve.

55. Trade in agriculture, not surprisingly in view of its previous exclusion from multilateral negotiations, remains the hard-core unresolved issue. The substantial achievements made should not be underrated, but more progress still needs to be made here.

56. Assuming no major political upheavals, an underlying 3 per cent per annum real average GDP growth rate appears to be achievable for the industrial market economies in the remainder of the 1990s. On past indications, this might be associated with a 5-6 per cent annual real average growth rate in trade. Such trends in the international economy, which continues to be dominated by the industrial market countries, would permit adjustments in production structures of goods and services, making room for suppliers from the better situated countries in the eastern part of Europe as well as from developing countries.

57. Over the medium term, fiscal adjustment in Germany is expected to permit some monetary easing, thus reducing the interest rate differential vis-à-vis the dollar. This is expected to lead to some strengthening of the dollar vis-à-vis the Deutschmark. Little change, however, is expected in interest rate differentials between Japan and the United States and thus little change in the dollar/yen exchange rate. The relatively low current value of the dollar is expected to persist facilitating further adjustment in trade balances.

58. The outlook for output and trade for the medium- and long-term in Central and Eastern Europe reflects short-term prospects, ranging from modest optimism

to gloom. The time required for transition and reconstruction in the three Central European countries furthest along in the reform process (Czechoslovakia, Hungary and Poland) is generally taken to be 5-10 years. That is, substantial changes in these countries should be evident by the end of the 1990s. But the restructuring process could take longer. The key issues are political - that is, whether and for how long, the populations of these three countries will be able to shoulder falling standards of living, unemployment and other welfare costs of transition. Only time will tell. Clearly there is much that the industrial market economies and multilateral organizations will be able to do over the medium term of 5-10 years to make the transition processes tolerable for these three countries.

59. In the other countries of Central and Eastern Europe the process of change is less well advanced. It is likely to take longer and the costs of change are likely to be considerably higher. Even the Baltic States are likely to find the transition to markets extremely difficult. For the area as a whole the requirements of raising investment in agriculture, manufacturing, infrastructure and housing to achieve living standards comparable to those of industrial market economies are enormous. Flows of capital and technology from abroad will be helpful, but it is clear that the bulk of such investment, as in successful developing countries, must come from domestic efforts and particularly from domestic savings. The breakup of the former systems of planning, payments and trade will take time to overcome. Implementing a basic legal structure, particularly with regard to land and other property ownership, introducing the institutions that enable markets to operate, privatizing the major productive State enterprises as well as the mass of small- and medium-sized businesses, managing infrastructural facilities and building up service enterprises such as banks, constitutes a large agenda. Yet all these steps are necessary for effective macro- and micro-economic management.

60. Recent projections of growth prospects for developing countries seem more positive than they have been for many years (tables 2 and 3). They suggest that aggregate GDP growth rate could increase from about 3 per cent in 1991 to nearly 5 per cent in 1992, and then to average about 5-1/2 per cent through 2000. South, South-East and East Asian countries could continue to do well, with continued rapid growth fluctuating within a range of from 5-1/2 to 8 per cent among the newly industrializing economies as well as in Indonesia, Malaysia and Thailand, about 5 per cent in India, and about 7 per cent in China. The Latin American aggregate GDP growth could increase from less than 3 per cent in 1991 to about 3-1/2 per cent in 1992 and then to average about 4-1/2 per cent through 1996. These projections mainly reflect an acceleration of growth in Brazil and Mexico, fluctuating between 4 and 5-1/2 per cent, and the continuation of moderate growth in Chile, Colombia and Venezuela. In sub-Saharan Africa, GDP growth rates could settle in the plus-3 to 3-1/3 per cent range. This would, however, still exceed population growth rates.

61. Unfortunately not all developing countries are on the "up" escalator. A number of small, very poor countries, including most of the least developed countries, are expected to continue to lag behind the others. These include countries in sub-Saharan Africa, Central America and the Caribbean.

1. Current account imbalances

62. A major improvement has occurred in recent years in trade and current account imbalances among industrial market economies. Large deficits (notably in the United States) exerted pressures on exchange rates leading to devaluation and hence stimulating exports. Current account deficits have thus been halved in relation to GDP. The current account deficit of the United States which was slightly more than 2 per cent of GNP in 1990 is expected to remain below 1 per cent during the period 1994-2000, although a reversal in the recently improving trend is expected to emerge in 1995 unless further adjustment measures are taken in that country and in Japan. A potentially explosive situation has thus been brought under control. The international implications of these imbalances remain moot. Japan and some European countries apparently wish to supply capital to the world. The United States, Australia and some other industrial market economies have been borrowers. In part, such borrowing has stimulated imports from developing countries. The welfare outcomes of such savings and borrowing patterns are still subject to differing interpretations. Had the borrowing industrial market economies saved more, interest rates might have fallen, and greater capital flows at relatively low costs might have gone to developing countries. But other outcomes may be postulated. As industrial country deficits no longer threaten stability, their impact can be explored calmly and analytically.

63. The current account imbalance issue is closely related to the adequacy of finance for development purposes and to assist the transition of the countries of Central and Eastern Europe to market economies. Even though external capital flows are only important at the margin, the margin, as always in economics, can be critical.

2. Global savings

64. Capital flows range from emergency relief through assistance for development to the commercial availability of capital for private direct foreign investment, bank loans and bond issues.

65. International capital flows have many forms and varying volume. The capital flows are mutually highly complementary, and they are also complementary to trade. Different countries benefit from different mixes of funds at different times. During periods of rapid growth, some developing countries have borrowed for periods of 10 years or more and yet serviced their debts easily because they used the capital they borrowed productively. Excessive borrowing, on the other hand, has led to waste and high indebtedness. Some countries remain burdened by debt. Their balance of payments is constantly at risk. Although the number of countries with high debt exposure is declining, for those still in this group retiring debt remains pressing.

66. Capital flows to developing countries and the countries of Central and Eastern Europe are small in relation to intra-industrial market economy capital flows and yet fears that global savings will be insufficient to meet developing and Eastern European requirements in the 1990s are growing. It is being argued that some groups of countries will be "crowded out" by the more rapidly growing countries such as the newly industrializing and the near newly

industrializing developing economies. The resulting pressure on interest rates would raise the cost of capital, particularly to poorer countries.

67. An assessment of the prospects for net capital flows to developing countries must take into account the determinants of its various official and private components. According to a recent assessment of the World Bank, official grants and bilateral loans can be expected to increase at about the same rate as nominal GNP in the developed market economy countries. Substantial increases in those growth rates or agreements to protect the global commons, which would add significantly to the capital requirements, would, of course, require additional financing.

68. For countries dependent on ODA for the bulk of their external development finance the poor prospects for growth in ODA grants and loans are particularly serious. For these countries it is especially important that disbursements of concessional assistance to the countries in transition be financed from additions to aid budgets in donor countries which would raise their ODA/GNP ratios substantially.

69. For countries financing the bulk of their external financial requirements at commercial rates of interest, it is of some concern that interest rates could rise as economic growth accelerates in the industrial countries. This would not only affect the cost of borrowing on private markets but also the interest rate charged on loans by the international financial institutions.

70. The reduction of military expenditures could over time lead to a productive use of the resources they represent. In principle this is a potential source of accelerated global growth, but caution is necessary in evaluating the potential gains for the short and medium term. Many military expenditures have localized and regional objectives. Military expenditures are relatively small in relation to GDP in the industrial market economies (6 per cent in the United States, 3 per cent in Europe and 1 per cent in Japan). Military expenditures usually cannot be cut overnight. Soldiers have to be re-employed and housed, and military production has to be transformed into non-military uses. Boots and uniforms cannot become fashion footwear and garments without considerable design and other changes.

71. Recent estimates of the effects of declines in military expenditures are based on the assumption of a cumulative decline of 18 per cent in United States defence expenditures in current prices between 1991 and 1995. This would mean a reduction of $56.4 billion. With additional cumulative reductions of 16 per cent for the four-year period 1992-1995 by the seven largest industrial countries, this would generate additional budgetary savings of about $52 billion in 1992, rising to $112 billion in 1995. Such budgetary savings would be sufficiently large to support substantial increases in external financial assistance to countries with economies in transition, to developing countries pursuing structural adjustment, and increased priority domestic spending or deficit reduction in the industrial countries. On the other hand, it must be remembered that an additional 1 per cent global growth would immediately generate $250 billion in additional resources and add resources cumulatively thereafter. Growth thus remains the highest priority.

3. Trade

72. The major international issues remain, as always, concerned with trade. Tension has been developing between the regional arrangements in Europe and North America and the multilateral system. East and South Asia are being pushed into unwarranted and uneconomic regional arrangements by the European and North American political drives that underlie their regional ambit claims. The economic instruments that are being used to cement political alliances often have economic costs.

73. One of the major contributions of the Uruguay Round has been to exert trade liberalizing pressures on the regional arrangements. But when the Uruguay Round is concluded, the pull and push between the supply of, and demand for, protection will continue. The very ending of the Uruguay Round process could increase protection, exacerbating the dangers of regional "fortresses". It is thus important that the Uruguay Round does not merely peter out but that a continuing process of negotiation is left in place. The failure to follow up the Tokyo Round codes of conduct effectively did much to weaken the multilateral negotiating process in the 1980s. Mechanisms for trade policies surveillance and dispute settlement, strengthened as part of the Uruguay Round, are expected to be pursued more vigorously at the end of this Round.

74. The countries of Central and Eastern Europe are making a strong claim for privileged access to west European markets. Such access could be at the cost of countries that already receive preferential access to European markets (notably southern EC members and near members, other Mediterranean countries, the African/Caribbean/Pacific group of States participating in the Lomé IV Convention and recipients of the Generalized System of Preferences (GSP). In practice, privileged market access has had little practical value, but to the inexperienced countries of Central and Eastern Europe it appears to be highly advantageous, particularly in the short run. The industrial market economies, knowing such concessions to be of little value, find them easy to give. Unfortunately the principal effect of preferences is highly divisive. The fragmentation of trade arrangements puts the multilateral system in jeopardy. In the not so long term even minor trade diversion decreases potential productivity, reducing growth and living standards. Excessive extension of trade preferences would even undermine the 3 per cent annual real average growth rate postulated for industrial market economies to the end of the century.

75. Some of the developing countries threatened by a proliferation of new preferences have taken other steps to remain competitive. They have come to the fore of countries arguing for further trade liberalization, replacing the industrial market economies as liberalization leaders. The 1970s and 1980s experience of leading exporters suggests that appropriate macroeconomic policies and high productivity at the enterprise level are more effective in vigorously expanding market penetration than privileged market access.

IV. ENVIRONMENT, DEVELOPMENT AND POVERTY

76. Historical patterns of economic development have produced rapid economic growth in the industrial world for an extended period of time. This is reflected in high standards of material well-being with patterns of consumption that are absorbing large quantities of renewable and non-renewable resources of the world. At present the consumption rates of primary raw materials are many times higher in the developed than in the developing world.

77. These patterns of development have been based on the depletion or mining of the natural capital through direct extraction of non-renewable natural resources, the consumption of renewable resources at an unsustainable rate and the generation of wastes beyond the capacity of the environment to assimilate them. This is reflected among other things in a rapid loss of biodiversity, partly because of deforestation in countries with temperate climates, the creation of holes in the ozone layer in the upper atmosphere and the emergence of a serious threat of global warming.

78. In the last two decades people have become increasingly aware of the social costs associated with production processes and consumption patterns that harm the environment. Such harm is sometimes localized and affects only the people who cause it, but more often it affects neighbours or citizens living in other regions, or future generations.

79. Institutional structures and economic systems in developed market economies, centrally planned economies, and even in developing countries have shown a consistent failure to avoid environmental destruction. Sustainable development requires in the case of all societies policy reforms that take into account past errors in the management of natural resources and fragile ecological systems.

80. The Committee reviewed in some detail the most pressing environmental issues currently under discussion internationally. The review covered such global environmental problems as global warming, ozone depletion, loss of biodiversity, and deforestation; in addition, it examined more local issues, many of which affect particularly the poor, such as lack of access to adequate water supplies, deterioration of arable land, the impact of deforestation on access to fuel by the poor and changes in microclimates resulting from loss of forest cover. The problems of water and air pollution and waste management also were analysed.

81. In recent decades national Governments, specialized regional institutions, governmental and non-governmental organizations at the local level, and some international organizations have begun to attempt to develop effective means of avoiding socially undesirable environmental effects. These experiences, both failures and successes, provide useful lessons for a concerted effort to devise and improve policies that ensure that increases in human welfare are sustainable.

82. International concern and attention in the discussions leading to the United Nations Conference on Environment and Development quite properly was focused on the global dimensions of the problem. Emphasis was placed on the threats to the global environment posed by a continuation into the indefinite

future of current patterns of human activity. Technical analysis was devoted to increasing our understanding of the complex processes which constitute the physical environment, to estimating the carrying capacity of the ecosystem and to comprehending the fundamental physics, chemistry and biology that determine how the environment responds to disturbances originating from man-made interventions. Only then was it possible to assess even tentatively the extent of the threat to the environment and to discuss the possible efficacy of alternative remedies. Parallel to discussions by the natural and social scientists, there have been extensive consultations at the political level, especially in the Preparatory Committee meetings that have formed part of the Conference process, aimed at reaching a consensus on policy instruments that simultaneously permit economic development, the alleviation of poverty and protection of the environment.

83. Recent work by the Committee for Development Planning, especially in connection with the International Development Strategy for the Fourth United Nations Development Decade but also in the context of economic reform in the developing countries, has highlighted the interconnections between development, poverty alleviation and the environment. There is no need to repeat those arguments here. 3/ Instead in this chapter we seek to contribute to the current debate on development and the environment by addressing the question of the impact at the global level of world-wide patterns of production, distribution and consumption on the resource base - i.e., on the world's stock of natural capital, paying particular attention to the relationship between poverty and environmental degradation in developing countries.

84. There are indeed environmental dangers inherent in current rates and patterns of growth in global production and consumption. Yet there is no inherent conflict between the reduction of poverty and the maintenance of the stocks of natural capital at viable levels. The central point is that if the value of the aggregate capital stock - natural and man-made - falls, the prospects for development are reduced, but if the value of natural capital falls, development prospects can be maintained provided man-made capital is increased in compensation. In so far as the stock of natural capital is damaged or consumed at an excessive rate, the prospects for future development are reduced. In that sense good environmental policies are part of good development policies. This is true whether one is concerned with degradation of the environment at the local level (such as the pollution of fresh water supplies), at the international level (such as damage to forests in neighbouring countries downwind of factories emitting sulphur into the air), or at the global level (such as destruction of the ozone layer in the upper atmosphere caused by high emissions of chloro-fluorocarbons (CFCs)).

85. If one's perspective on the environmental problem is that of the present and future welfare of people, damage to the environment can be seen as a consequence of human activity induced by a set of incentives which leads to a neglect or disregard of some of the costs of economic activity, be it production or consumption. It is instructive to see all environmental problems - all apparent conflicts between development and the protection of the environment - as arising from either government failure, market failure, missing markets arising from undefined property rights, or a situation in which the income-earning opportunities to which the poor have access are insufficient to sustain life without depleting the stock of natural capital.

This is true whether one is concerned with global environmental issues which threaten the sustainability of life on Earth or local issues of significance only to a restricted population.

A. Government failure

86. By government failure we mean actions taken by local, provincial or national governments which create incentives to use the environment, the natural stock of capital, wastefully and inefficiently. Examples of government failure are policies which subsidize the cost of water to users (as in the western states of the United States and in many canal irrigation schemes in developing countries), policies which subsidize the cost of land to ranchers and agriculturalists and often encourage otherwise unprofitable economic activities in areas where the resource base is fragile or marginal (again, as with the leasing policies of government-owned land in the western regions of the United States and in many subsidized resettlement schemes in developing countries), and policies which subsidize logging, and provide little incentive for replanting, in the tropical forests of developing countries or in State-owned woodlands in temperate climate countries.

B. Market failure

87. The second source of defective incentives arises not from government subsidies and other forms of government failure but from market failure. This occurs whenever prices generated by the market mechanism fail to reflect fully the costs of production and consumption. In such cases economic activities produce negative externalities ("bads") as well as goods. The significance of this is that in a market economy producers and consumers respond to market signals. This leads to an efficient use of resources, including use of the stock of natural capital - i.e., the environment - only if prices accurately measure all costs. Where, however, environmental costs are understated by market prices, producers and consumers have an incentive to use resources wastefully and to overproduce those goods that use intensively the under-costed resource.

88. Unfortunately, many economic processes generate negative externalities and this is particularly true in technologically advanced economies. Examples include the pollution of the air by trucks and automobiles, pollution of rivers and lakes by factories dumping noxious waste in inland waterways, salination of the land in areas where irrigated agriculture unaccompanied by proper drainage is practised, and pollution of coastal waterways by the discharge into the sea of untreated sewage from large cities. Market failure is widespread in the industrialized countries and this accounts for the fact that most global environmental damage to date is the result of past and current production and consumption patterns in the advanced economies. The industrialized countries in the mid-1980s, for example, accounted for about 75 per cent of the carbon dioxide and 90 per cent of the chloro-fluorocarbon emissions, the two gases that are believed to cause global warming. In addition, the industrialized countries consume about 10 times as much energy, water, minerals and biomass as do the developing countries. Thus the developed countries bear primary responsibility for past and present global environmental problems, and it is they who have the major obligation to repair

the damage. This is a straightforward application of the "polluter pays" principle.

89. The existence of negative externalities and market failure do not imply that either developing or developed countries should slow down their growth in the name of environmental protection. It is clear, however, that if environmental issues are not confronted now, severe environmental constraints may emerge and past patterns of development will be impossible to sustain. The implication of market failure, therefore, is that Governments should intervene to correct market prices (or impose direct controls) so that producers and consumers respond to a set of incentives that accurately reflects all costs, including of course environmental costs. How Governments might best intervene is touched on below, but what needs to be underlined here is that market failure is a cause of defective incentives not a symptom of excessive growth. The solution is to correct the incentive system, not to restrain the level or rate of growth of net output and income. Indeed, it would be accurate to say that while environmental policies could restrict growth in particular sectors or regions, overall they would enhance growth, provided growth is measured correctly by taking into account all benefits and all costs of production.

C. Missing markets

90. The third source of defective incentives occurs whenever a market for an environmental service is missing. These so-called missing markets arise when property rights are undefined or unenforced. Examples could be unclaimed forest land, common pastures under the control of no particular group or individual, fresh water aquifers from which anyone may extract water by digging a well; at the global level, missing markets include the high seas, the upper atmosphere and the polar regions. In cases where property rights are undefined, no one has an incentive to manage the natural asset to ensure a sustained flow of income and everyone with access to the asset has an incentive to extract maximum benefit as quickly as possible. The results are over-cutting of forests, over-grazing of pastures, withdrawal of water in excess of the re-charge rate, over-fishing the oceans, destruction of the upper atmosphere etc. Here again, however, the primary solution to the problem of missing markets is to correct the incentive system - this time by creating enforceable property rights, either individual, collective, state or supranational, or in some cases, by regulating access to the resource - not retard the process of development or diminish our efforts to reduce poverty.

91. The "polluter pays" principle might also be made to apply to the stock of "bads", the accumulated effects of past degradations of the stock of natural capital. Where the damage is reversible, as in renewable resources, restoration of the natural capital stock, in whole or in part, could in practice require large sums indeed and this is no straightforward issue. To the extent that natural resource depletions of the global commons of yesteryear were transformed into physical, financial or human capital now forming part of a country's capital stock available for production today, those responsible may well be held liable. It is, however, difficult to see how one would translate into operational terms the idea that previous generations should be called to account for neglecting the interests of the present generation. Where, however, some members of the present generation

have benefited disproportionately from the resource-depleting activities of previous generations, there may be a case for a compensating redistribution of income, provided of course the redistribution improves the overall world distribution of income. Where, in contrast, natural capital has been consumed - or otherwise used up without trace - it is gone forever and no intragenerational transfer can bring it back.

92. This is not the place to elaborate on this matter; to do so would require the introduction of such concepts as the optimum stock of natural capital, the appropriate rate of restoration of the stock (assuming the loss is not irreversible), and of principles of interpersonal, international and intergenerational equity and fairness. Whatever the outcome of such analysis, it seems to us implausible that an agreement could readily be worked out. In the meantime at least a major step forward could be taken by putting the "polluter pays" principle into effect in respect of current pollution costs.

93. Indeed, if the incentive system were corrected so that producers and consumers responded to signals that reflected the true costs of economic activity, net output and income would rise: more "goods" and fewer "bads" would be produced. Relative prices would change to reflect all costs, including the cost of natural capital, but the level of total output and of total income need not change and they certainly need not fall. In fact, since the improved incentive system would stimulate a more efficient use of resources, output and incomes correctly measured can be expected to rise.

94. Much confusion surrounds this point, and it frequently has been claimed that huge costs will have to be incurred to prevent further damage to the environment and that this diversion of expenditure inevitably will be at the expense of a lower level of consumption, slower growth and a diminished commitment to the alleviation of poverty. This is quite wrong. A change in the structure of incentives to take environmental costs into account implies that the pattern of expenditure, the composition of outlays, will alter to reflect true scarcities and true benefits. There is no implication at all that the level of current expenditure will be higher or that the level of investment expenditure need be higher. There is, however, an implication that a new set of incentives would, for example, discourage consumers from driving their automobiles as frequently as before while encouraging them to spend relatively more, say, on environmentally benign products such as cotton shirts. Similarly, investors would have a greater incentive to invest in technologies that reduce environmental costs and perhaps a relatively smaller incentive to adopt technologies that reduce labour costs.

95. It would be facile to pretend that changing the set of incentives faced by producers and consumers will be easy or that the ideal or optimal set of incentives can readily be determined. A number of difficult issues remain. For example, it is not obvious how one should calculate the option value of preserving a species, plant or animal, with no known current utility, but it is evident that the value presently attached to the preservation of biodiversity - namely, zero - is too low. Similarly, it is not obvious what the appropriate rate of discount should be when assessing the present value of environmental costs inflicted on future generations - e.g., costs associated with storage in perpetuity of waste from nuclear power plants - but it is evident that under the current set of incentives the discount rate is too high and the interests of future generations are underrepresented. Lastly, it is

not obvious how the costs of preventing a further deterioration of the environment should be spread among the generation alive today, but it is evident at a global level that the benefits of production and consumption activities which damage the global environment accrue disproportionately in the developed countries whereas the costs are borne disproportionately in the developing countries.

96. This last point is controversial and deserves elaboration. Consider biodiversity. The costs of preventing a further decline in the number of species on Earth will fall mainly on the developing countries in the tropics, for that is where the remaining species are concentrated, diversity in the temperate regions already having been reduced substantially in the course of species-intensive economic development. The future benefits of biodiversity, on the other hand, will be reaped by mankind as a whole since under the present property regime there are no ownership rights attached to natural species (although ownership rights are routinely attached to species created in laboratories). We have here a case of missing markets acting to the disadvantage of developing countries.

97. Consider negative externalities generated in the process of industrialization. In some instances the externalities are concentrated in a particular locality and do not cause global damage. The products of the pollution-generating industries may, however, be traded internationally. The question is whether the same emission standards should be applied in all countries in the name of fair competition and a "level playing field". The answer to this question is no: there is no reason why the standards adopted in the already heavily polluted developed countries should be imposed on the relatively less polluted developing countries. On the contrary, a correct set of incentives would ensure that on the margin the cost imposed on people by negative externalities would be the same in all countries, and this implies - everything else being equal - that the location of industrial activities should shift from developed to developing countries. Demands in the developed countries for identical emission standards everywhere, regardless of differences in circumstances, amount to demands for protection and are themselves a form of unfair (and inefficient) competition.

98. The above reasoning does not imply, however, that the migration to developing countries of polluting industries should be encouraged without qualification. Further pollution in already polluted areas should be discouraged through regulation and taxation, and developing countries should also set pollution standards, compatible with their specific environmental situation and their desired level of environmental quality. There is no reason in principle why the desired level of environmental quality should not be different in developing countries from current standards in industrialized countries. It is important to recognize, however, that what is at issue is the standard of environmental quality, not industry. That is, we are not concerned with dirty industries, but with dirty air, dirty water, and so forth.

D. Reducing global emissions

99. In cases where economic activity generates negative externalities at the global level, the problem cannot be solved merely by changing the location of the industry from a more polluted to a less polluted environment: the level

of emissions must be reduced overall. The question then becomes how best to do this, and the answer in general terms is that efficiency requires that the "polluter pays" the cost of correcting the externality. There are several ways this can be done. For example, a uniform global tax could be imposed on emissions generated by the burning of fossil fuels. This would lessen the danger of global warming by creating incentives, first, to reduce fuel consumption; secondly, to find more efficient methods of combustion; and thirdly, to discover and use alternative sources of energy. The cost would fall primarily on the industrial countries - as it should, since that is where the globally damaging externalities are generated.

100. Another possibility that has been widely discussed is to issue emission permits, allowing holders to discharge chemical particles into, say, the air up to a pre-set maximum. These emission permits would be tradeable, or perhaps auctioned, thereby allowing those for whom the "right to pollute" is most valuable to purchase such rights, but only by paying a market clearing price. Such a system of tradeable permits could be applied locally, nationally or internationally as appropriate. The scheme has the advantage of combining fixed limits on the tolerable level of pollution with flexibility in allocating rights to pollute to the industries and enterprises where such rights are most valuable. If a scheme of this sort were introduced internationally, the initial distribution of emission permits could be skewed towards the developing countries, thereby ensuring that the revenues raised by the scheme accrued disproportionately to the poorer countries, the major losers from past misuse of the global commons.

101. Alternatively, global emissions could be reduced by transferring to developing countries existing technologies in use in developed countries which are, say, more fuel efficient, provided the technologies transferred meet the local standards for environmental quality. It has been proposed that the transfer should be at zero cost to the developing countries, or if not, the cost should be heavily subsidized. Such a transfer would be one way to reduce total emissions at the global level and as under a carbon tax scheme, the cost would be borne largely by the developed countries. This is merely another application of the "polluter pays" principle - an efficient way of attaining a desired objective - and should not be confused with foreign aid intended to promote economic development. Rather the cost of technology transfer should be seen as payment by developed countries to developing countries for services rendered. From a global perspective it does not matter where the reduction in pollutants occurs so long as the developed countries (the polluters) pay for it.

102. Yet another alternative would be for the developed countries to finance research into new technologies designed to cut emissions, and to make the technology available to all potential users free of charge. Once again, this is not an example of foreign aid but merely an application of the "polluter pays" principle. The method ultimately chosen to reduce global externalities is of secondary importance, and in which countries the method is applied matters not at all; what is important for efficiency is that the cost of implementing the chosen method be borne by those who inflicted the damage, namely, producers and consumers in the rich, industrialized countries.

103. Once the ultimate causes of environmental degradation are understood - government failure, market failure, missing markets and restricted access of

the poor to natural capital - and the general principles on how to go about correcting the problem are accepted - aligning government policies with social costs, internalizing externalities, creating well-defined property rights and increasing income-earning opportunities of the poor - the design and application of specific remedies for specific problems should be approached systematically on the basis of the criteria discussed above. There are formidable practical problems in trying to internalize the costs of pollution. Although the principle is clear, the institutional arrangements to achieve this objective may only approximate in a rough way the efficiency principles here postulated. The principles are the same whether the problem is local, transnational or global, and these principles are concerned with increasing efficiency in the use of resources, including the natural capital of the globe. They have nothing to do with foreign aid and little to do with notions of fairness, although in the case of global environmental deterioration, considerations of equity and efficiency happen to coincide with the application of the "polluter pays" principle.

104. A particular set of problems arises where the environmentally damaging effects of an economic activity extend beyond the borders of the country in which the activity is or was located and in which presumably most, if not all, of the benefits accrued. One problem is how to assess the costs of such damage - e.g., of an accident at a nuclear power station. A more fundamental problem is that there is no institutional mechanism for collecting claims against those responsible for damaging the environment or for distributing compensation to the victims. Institutional innovations at a global level clearly are required.

105. It must be recognized that as the developing countries become more industrialized, and as they adopt technically more complex patterns of production and consumption, the contribution of the developing countries to global environmental problems will increase unless the present set of incentives is altered in the ways outlined above. It is thus no consolation to the developing countries to know that most of the damage to the global environment in the past and in the present can be traced to the activities of developed countries. The same cluster of issues will arise with equal force, and for a much larger number of people, in the developing countries. The developing countries thus have a strong interest in changing the structure of incentives, locally, nationally and globally.

E. Poverty and the environment

106. The argument so far has been that there is no case for developing countries to reduce their rate of growth or to diminish their efforts to alleviate poverty. This argument has been based on considerations of efficiency; questions of equity have been largely ignored. However, it was stated early on that a major cause of environmental problems in developing countries is restricted access by the poor to income-earning opportunities, including opportunities arising from ownership or control of sufficient natural capital to sustain life above a subsistence level. In this section, some of these issues of poverty are addressed.

107. An analysis of environmental problems in developing countries leads to the conclusion that in many cases the alleviation of poverty by providing greater access by the poor to resources and employment, and by promoting human development, is probably the most effective policy. Land degradation and desertification is concentrated in areas where poverty leaves the population with little alternative but to overuse resources. Deforestation, too, is often the last resort of people who cannot find other means of generating minimum levels of income. Rural poverty and environmental damage thus often go together, and the solution to the latter is to eliminate the former.

108. Economic development creates opportunities for people to shift to activities that do not permanently damage the environment. Agricultural development and investment in fertile areas, for example, create rural employment opportunities and this diminishes the pressure on peasants to cultivate fragile lands in clearings in tropical forests. Employment creation in both rural and urban areas, often a product of successful structural reforms, reduces the incentive of poor people to expand the agricultural frontier into economically marginal environments.

109. On balance, both nationally and internationally, it is the rich who are responsible for most environmental damage and who benefit from it. Thus policies which redress environmental problems by encouraging an efficient use of the stock of natural capital are likely to change the distribution of income in favour of the poor. Having said this, however, it must be recognized that not all policies intended to correct environmental problems help the poor; occasionally the poor are harmed, and when this occurs, compensating policies should be introduced. Application of the "polluter pays" principle should not be allowed to impoverish further people who already have to struggle to make ends meet.

110. Consider an example of user fees for urban water. In principle, water charges in urban areas should cover the opportunity costs of water plus the cost of water purification and drainage. In some cases the imposition of full costs for water would seriously harm the urban poor. The response in such cases should be subsidies to the incomes of the poor (financed perhaps by water charges), not reduced access by the poor to water. Indeed in this particular example, a subsidy would be justified not only on income grounds but also on grounds of external benefits to the community at large of a universal system providing safe water and drainage facilities. Environmental considerations require water charges, but public health considerations require universal access to water. Thus a balance must be found between water charges, public expenditure on water and drainage, and income subsidies.

F. International burden-sharing

111. There are no quick solutions to the problem of sustainable development, nationally or internationally. Technically feasible solutions are available in many areas or can be found in others, but in some cases the costs involved may be high. Altering relative prices to reflect true costs of resource use will be less expensive, but the administrative issues may be difficult to resolve. In either case, achieving a socially desirable rate of growth, alleviating poverty and maintaining the integrity of the environment all at once at the national level may require not only a reallocation of resources

but additional resources as well. Beyond this are the resources needed to prevent further international and global environmental damage arising from economic activities in the developing countries. To achieve both developmental and environmental goals will call for new thinking in the area of burden-sharing between the developed and the developing countries.

112. Even if the cost of preventing further damage to the stock of natural capital turns out to be high, one cannot indefinitely consume one's capital, whether natural or man-made, and in most cases timely action to prevent further deterioration will be much less costly than delayed action. In a broad sense, financing environmental protection should be viewed as an investment in maintaining the productive capacity of the global natural resource base.

113. Since the developed countries are the principal global polluters, they have an obligation to bear their share of the cost of reducing environmental damage. This can be done in a variety of ways - e.g., by financing of environmentally sound technologies in developing countries. The important point is that whatever funding is needed to improve the global (as opposed to the local or national) environment should be based on the "polluter pays" principle and should not be confused with traditional development aid.

114. A number of innovative approaches to funding environmental activities have been proposed. Examples include debt relief; charges for the use of the global commons; a non-renewable energy, or carbon, tax; and tradeable pollution permits.

115. Charges for the use of the global commons - that is, the resources on the seabed, ocean fishing, use of the high seas by shipping, use of the atmosphere for air transport - could yield substantial revenues and these revenues could be used to protect the global environment and possibly also to assist developing countries to confront local environmental problems arising from lack of access of the poor to income-earning opportunities. The charges could be levied and collected through an international taxing authority established under the United Nations.

116. A non-renewable energy or carbon tax has been proposed and widely debated. As discussed above, the primary objective of such a tax would be to alter the behaviour of polluters by raising the cost of highly polluting technologies and fuels. If necessary, such a tax could be phased in gradually in order to give producers and consumers time to adjust to a change in relative prices and costs.

117. Tradeable or leasable permits, as discussed above, combine controls with market flexibility. They also allow substantial transfers of resources from one country to another to occur on the basis of market transactions. A facility might also be established for compensating developing countries for the opportunity costs of preserving tropical forests financed by assessments based on ability to pay. Such compensation could be viewed as payment for providing environmental services to the international community.

118. In summary, mechanisms can readily be envisaged which would reduce environmental damage considerably while permitting the maintenance and even

acceleration of the sustainable growth of net output. In the process the distribution of income, globally and nationally, probably would improve, although safeguards would have to be introduced in specific instances to protect the interests of the poor. A clean and safe environment, sustained development and the alleviation of poverty are compatible goals.

V. ECONOMIC REFORM IN DEVELOPING COUNTRIES

A. Characteristics of economic reform

1. Differences in objectives and time horizons

119. During most of the decade of the 1980s economic policy makers have been preoccupied with acute balance-of-payments imbalances, debt-servicing difficulties and hyper-inflation. "Economic reform" has, thus, become nearly synonymous with adjustment policies aimed at solving such pressing immediate problems. However, achieving long-term development objectives such as increasing the trend rate of GDP growth, reducing unemployment, improving levels of human development, reducing the incidence of poverty and mitigating environmental degradation also require economic reform. Economic reforms addressed to such long-term development objectives typically involve adopting measures to increase the share of investments in GDP; to improve its allocation as between enterprises producing for export and those producing for the domestic market; to improve its allocation between physical capital and human resource development; to improve the allocation of current income between private activity and necessary public activity; to improve the allocation of public expenditures; to develop appropriate regulatory mechanisms; and to devise efficient mechanisms for effecting transfer payments from the rich to the poor.

120. Often, policies appropriate to the attainment of long-term development objectives will not produce dramatic results in the short or medium term but need none the less to be pursued consistently if they are to achieve any results at all. Some policies - for instance, export promotion or tax reform - may have favourable effects on the size of fiscal deficits or on the balance of payments within a sufficiently short period of time to be considered integral components of medium-term structural adjustment programmes. Other policies needed for long-term objectives may, however, have negative consequences for the short-term objectives of stabilization programmes - for example, certain income redistribution schemes or increased outlays for health and education.

121. Economic policy in a very large number of developing countries in the 1980s came to be dominated by serious macroeconomic problems of external and domestic balance and by the constraints arising from the stabilization and adjustment programmes put in place to face those problems. This has continued into the 1990s. In more than two thirds of the developing countries, and in particular in Africa and in Latin America, real income per capita declined in the 1980s, suggesting the pervasiveness of the unfavourable external shocks and inappropriate domestic policies.

122. The traditional stabilization programmes of the IMF were dominated by two fundamental prescriptions: public sector deficit reduction and price reform. Cuts in government spending, large devaluations and positive real interest rates would allow a suppression of the rationing mechanism for foreign exchange and domestic credit allocation, while resolving the balance-of-payments and inflation difficulties. A sequence of negative external shocks, including the first and second oil shocks, the 1979 interest rate shock, the back-to-back world-wide recessions of 1980 and 1982, the 1982

collapse of international bank lending to developing countries, and a persistent decline in commodity prices, made it clear that developing countries faced an extremely adverse external environment. A major structural adjustment effort was required. This could not be achieved with traditional IMF policy recommendations only which had been designed for short-term stabilization programmes.

123. The accumulated experience with IMF programmes also indicated several limitations. First, large devaluations proved to be inflationary in a context of real wage resistance, as a consequence of which many countries did not manage to meet the agreed inflation targets. Secondly, large devaluations caused significant drops in industrial output, as imported intermediary products became suddenly too expensive, while exports did not always respond sufficiently. Large devaluations also tended to affect negatively the government budget, in cases in which revenues from import and export tariffs were small when compared to public sector external debt service. Thirdly, budget adjustments made under the pressure of meeting three-month targets frequently proved to be short-lived. In the short-run, Governments generally succeeded only in "deficit repression", often obtained through the suspension of much needed but easy to cut investments in social and economic infrastructure; growth-oriented "deficit suppression", as required for sustained price stability, would require a longer-term horizon. Fourthly, private savings did not respond positively to the very high real interest rates normally accompanying Fund programmes: on the contrary, the financial fragility brought about by the impact of high real interest rates frequently led to bankruptcies and financial collapses, besides increasing the costs of servicing the Government's domestic debt.

2. Description of the current reform package

124. The contribution of the World Bank, when it began lending for structural adjustment in 1980, was to emphasize that, besides stabilization, developing countries also needed structural adjustment to be achieved over the medium term by the adoption of liberal economic policies. This revised package became increasingly associated also with the lending programmes of the regional development banks. By the end of the 1980s, adjustment lending represented almost one third of the Bank's total lending commitment. The new Bank/Fund adjustment recommendations, which are sometimes referred to as the "Washington consensus", are embodied in five principles:

(a) Budget balancing;

(b) Relative price correction;

(c) Trade and foreign investment liberalization;

(d) Privatization;

(e) Domestic market deregulation.

125. Trade liberalization was to be achieved in a sequence of moves, starting with the replacement of quotas by tariffs, followed by a process of tariff unification and finally a programmed reduction of the unified tariff, until

reaching substantially free trade a few years hence. Foreign investment liberalization essentially meant non-discriminatory treatment vis-à-vis investment by domestic residents.

126. Privatization involved, firstly, the devolution to the private sector of formerly private firms that for one reason or other had fallen in the hands of the public sector; secondly, the closure of loss-making public enterprises; and thirdly, the transfer to the private sector of large public firms that were in the past thought to be of strategic importance.

127. Domestic market deregulation involved policy actions in goods market, labour markets and financial markets. Typically, the objective was to free those markets from governmental controls, letting prices be determined freely by supply and demand. Mechanisms to guarantee free competition and a prudent bank regulatory framework should however be established. Deregulation would also involve the introduction of an adequate legal system for the protection of property rights, as well as the prevention of the abuse of market power.

128. One welcome consequence of this expanded agenda was the recognition by the Bretton Woods institutions that adjustment in developing countries was a more complex task and would take longer than originally envisaged. Stabilization and balance-of-payments problems could not be dealt with productively within a short-term perspective but should rather be viewed as an integral part of the development challenge. The traditional view remained that building the confidence of the private sector, through a combination of fiscal discipline and liberal economic policies, was all that was required for a successful growth-oriented adjustment effort.

3. Contrast with long-term development programmes

129. When structural adjustment programmes are meant to be "growth-oriented", the distinction between them and long-term development strategies begins to blur. For one thing, it becomes possible to question elements in a structural adjustment programme which would work against achieving long-term development objectives. This may be illustrated by describing different approaches to fiscal adjustment.

130. Durable fiscal adjustment takes time to achieve. What can be used in the short-run are temporary stop-gap measures, such as a one-time steep increase in public sector prices, infrastructure investment reduction, payment delays to domestic creditors and suppliers, postponement of salary adjustments to government employees and an external public sector debt moratorium.

131. Deficit suppression - that is, attaining a budget that is sustainable over a longer period - might involve divestiture, deregulation, tax changes, debt consolidation, changed personnel policies and an incentive-focused public sector administrative framework. It also involves putting in place a new monetary regime, capable of avoiding the emergence of quasi-fiscal deficits in the central bank accounts, even when the fiscal accounts of the central government are under control.

132. This means that permanent fiscal adjustment requires deep institutional changes in the way that the central government operates and interacts with

other public sector entities and with the private sector. What is needed is the suppression of the potential budget deficit that arises from all the contingent governmental liabilities accumulated through the years, in the context of a statist soft-budget economic regime, in favour of different interest groups both inside and outside the public sector. Budget-deficit suppression requires in fact a thorough public sector reform involving at least two elements: measures to improve the efficiency of the economy and measures to increase public savings. This requires fiscal reform broadly understood, usually involving debt restructuring (domestic and foreign), elimination of rent-seeking entitlements, closure of hopelessly inefficient State enterprises and adoption of a more adequate tax system. But it usually involves also the elaboration of constitutional rules and a performance-oriented regulatory framework for State intervention that makes irresponsible deficit spending more difficult and the rules of the game for private investors more stable.

133. One aim of long-term development programmes is to improve social balance by explicitly incorporating such objectives as alleviating poverty, reducing the degree of inequality in the income distribution, and improving the socio-economic attainments of women. As has been discussed at some length by the Committee at its twenty-sixth session (1990), "policy makers should examine the net impact of the multiplicity of governmental activities ... on the incomes of the poor - women and men alike. ... A well-conceived strategy should include a broad and consistent set of measures, including ... (a) redistribution of land; (b) greater provision of agricultural services and rural infrastructure; (c) greater investment in the development of human resources; (d) removal of bias against the poor in expenditures on infrastructure; (e) social and legal reforms to enhance the full participation of women in economic and social institutions; (f) removal of unnecessary constraints on urban industry, especially small-scale enterprises, ensuring that prices of credit and other inputs reflect real scarcities; (g) family planning programmes and provision of birth control facilities; (h) greater democracy and participation of the poor in local electoral politics and in the creation of organizations that support their cause." 4/

134. While some of these have no apparent major implications for public expenditures, others certainly do, which suggests the need for a major redesign of certain programmes to focus "entitlements" on a narrower group of beneficiaries, or to achieve major cuts in other categories, such as defence.

135. Human resource development is central to the International Development Strategy. At its twenty-fourth session (1988) the Committee noted that "Expenditures on improving human capabilities have the potential to yield return to society no less than the return from physical capital formation". 5/ It focused attention on three broad categories: education and training; health services, water supply and sanitation; and food security and nutrition policies. In so far as possible, human development expenditures should be safeguarded from budgetary cuts. Since "the major beneficiaries of human development programmes tend to be males, households in large urban areas, and people with middle or high incomes ..., there [was] a need, particularly in times of structural adjustment, for governments to change the composition of their human development expenditure programmes to ensure that, on balance, most of the benefits accrue to those in the lower half of the income distribution. There may [also] be a case in some countries for

introducing user charges to help cover part of the cost of human development programmes [provided] they [are] designed so that they do not add to the regressivity of the tax system". 6/

136. If human resource development is an essential feature of successful long-term development strategies, it is no less clear that sustained growth requires high rates of investment. Yet an outcome of several stabilization attempts in the 1980s was a reduction in investment. Empirical evidence obtained in the 1980s regarding complementarity between public and private investment has shown that decreases in public investment may be detrimental to private investment in the long run even if public investment may dislocate private investment in the short run. The quality of public investment seems to be a critical growth-inducing factor, particularly in cases where an inadequate infrastructure requires the development of large and indivisible public projects to enhance private profitability prospects. Thus, the adverse impact of certain public expenditure cuts goes beyond the reduction in activity of the private sector - in particular, the construction sector - that occurs when the Government stops contracts for public works.

137. Negative long-run consequences of adjustment programmes could therefore be mitigated if indiscriminate reductions in public investment were replaced by a more judicious analysis of priorities concerning investment programmes. Growth performance following adjustment programmes could be improved by greater awareness of the complementarities between public and private investment.

138. The successful stabilization experience of Chile and the still ongoing ones of Israel and Mexico confirm the old truths that fiscal austerity, competitive real exchange rates, sound financial markets and deregulation are required for stabilization and that they provide the preconditions for a resumption of growth. These cases, however, also show the need to distinguish between necessary and sufficient conditions. Adjustment is strictly necessary, but it may not be sufficient.

139. Because physical investment is partially irreversible, rational behaviour by the private sector calls for withholding investment until much of the residual uncertainty regarding the success of the reforms is eliminated. Without investment, reforms are less likely to prove sustainable; but investment will not be forthcoming in the presence of uncertainty as to future policies. Hence, the conclusion that the success of policies may depend in no small part on the psychology of private sector expectations.

140. The role of expectations and of the "option to wait" also highlight the strategic importance of stabilization loans. A decisive step in that direction would be the support of creditor countries for the suspension of external debt service for a substantial period of time. This could provide the necessary financial safety net to dissuade potential speculative attacks and induce investors to reverse capital flight and start investment projects while supporting domestic confidence.

141. Finally, environmental sustainability has come to be seen as essential to sound long-term development strategies. Many environmental policies are in need of change as part of strategies to reduce rural poverty or to improve the quality of drinking water and air, which are essential to human health, and

this is widely recognized in the developing countries transition. However, adapting their regimen and enforcing norms to reduce pressure on global commons are likely to entail substantial costs whether in the form of administrative services to enforce regulations, direct outlays for public land management, or the indirect costs of technological adaptation in industry.

4. Contrast with "heterodox approaches"

142. A number of countries in the 1980s adopted heterodox approaches. These tried to take account of inflation rigidities and low supply elasticities by augmenting monetary and fiscal policies with wage and price controls. An effort was made not to violate equilibrium price movements, but to alter expectations of future inflation. This led to policy recommendations for price and exchange rate controls and de-indexation. Heterodox programmes also tended to downplay the need for an early fiscal adjustment, on the theory that substantial fiscal gains would be generated by successful price stabilization, and of the seigniorage revenues accruing as a consequence of the remonetization of the economy.

143. Many heterodox attempts fell in the trap of outright abandonment of fiscal adjustment. Premature reflating of the economy, inadequate price reform, weak investment incentives, and the use of import liberalization to repress domestic price increases in the presence of inappropriate exchange rates were the main inconsistencies of several attempts at heterodox stabilization. The Peruvian case, during the inti plan, epitomizes the worst outcome of such experiments, although different dosages of the same ingredients are found in Brazil's cruzado plan and Argentina's austral plan.

144. A narrowing of the gap between previously irreconcilable approaches has become apparent recently. This "professional convergence" which seems to be in progress is in part a consequence of a reflection on the failures of the most extreme versions of both orthodox and heterodox programmes. But in part it is also a reflection on the successes of experiments which managed to blend orthodox and heterodox elements in Israel and Mexico.

B. Regional variations

145. While the implementation of reform policies is quite widespread, there are significant differences among regions and among countries within regions both as to the objectives and scope of reform as well as in the impacts of apparently similar measures.

1. Sub-Saharan Africa 7/

146. There have been several patterns evident in reform programmes in Africa during the 1980s. First has been the increased intensity of reforms during the second half of the decade. Stabilization and structural adjustment programmes have been more widely adopted and more continuous since 1985 - so much so that it is possible to mark the middle of the decade as the real beginning of serious reforms in Africa. Second has been the increasing number of sectoral adjustment programmes adopted by African Governments during the

latter half of the decade. The less ambitious sectoral adjustment programmes have proven to be a useful introduction for some Governments to economic reforms and have proven helpful for others, already having implemented macroeconomic reforms, as a means of addressing remaining reform issues associated with particular sectors. A third pattern is that early reform programmes in Africa have tended to focus on the more easily implemented policy changes - for example, exchange-rate adjustments or price decontrols. The more difficult reforms, involving institutional changes, are yet to be addressed by most African Governments. Issues involving the sequencing of fiscal, trade and financial reforms which have so absorbed Latin American reforms have been less prominent in Africa where inflation has been far less of a problem and where financial markets remain at a very early stage of development.

147. The principal sources of information on the impact of economic reforms in Africa are the major lending institutions - the IMF and the World Bank. 8/ In 1985, the Fund published an occasional paper on the impact of its stabilization programmes in 22 countries of sub-Saharan Africa over the years 1980-1981. 9/ It found that only 20 per cent of these countries achieved target levels of growth, only half were able to reduce inflation to targeted ceilings and only one third were able to reduce the gap in their balance of payments to targeted levels. This disappointing record was attributed largely to problems with the implementation of agreed reforms.

148. In 1988, the World Bank study, Africa's Adjustment and Growth in the 1980s, argued that "there is evidence that the combination of reforms and added assistance has led to higher agricultural growth, faster export growth, stronger GDP growth and larger investment". 10/ These findings were challenged in a study published shortly after by the Economic Commission for Africa (ECA), which stated that despite structural adjustment programmes, "... there is documented evidence that in many cases sustained economic growth has not materialized, the rate of investment rather than improve has tended to decrease, budget and balance-of-payments deficits have tended to widen". 11/ The ECA study also argued that there were major adverse social consequences of structural adjustment programmes on the poor.

149. Why, it must be asked, has the impact of economic reforms in Africa been disappointing? In particular, why has the private investment regarded as necessary to sustain future economic growth so far failed to appear? First, the limited supply response to reforms can derive from shortcomings in the physical infrastructure and in government services necessary if farmers or businessmen are to produce and market more products. 12/ The lack of credit, viable technical packages, transport and communications often block the ability of Africa's farmers to realize or sustain increases in agricultural production and discourage investment in industry.

150. Secondly, Governments often failed fully to implement agreed reforms. As a result, changes in economic policies and institutions necessary to create an environment sufficiently attractive to private entrepreneurs to put their capital at risk have been inadequate. World Bank studies have found that roughly 80 per cent of the reforms included in structural adjustment programmes are eventually implemented by African Governments. While the record of implementation has improved during the 1980s, it is still lower in Africa than in other parts of the world. Moreover, the measures not

implemented may have been more important than those that were. What World Bank studies do not provide are important details on the implementation of reforms: how fully are they implemented and how long are they maintained? Reforms critical to promote new private investment have often not been tackled and can be administratively difficult to implement. For example, the reform of the banking system, often a necessity in African countries, tends to be complex technically and intense administratively. Governments with limited capacity can find banking and other institutional reforms especially challenging both administratively and technically.

151. A third view on why investment has been so slow to respond to reforms in Africa involves "governance", a problem raised by the World Bank to describe "the exercise of political power to manage a nation's affairs". 13/ This definition is so broad as to cover virtually every action of Governments but in fact, what the Bank seems to be referring to in the context of Africa is not the problems of policy failure or the weakness of public institutions but the behaviour of politicians and bureaucrats. Public officials in many African countries have too often behaved in unpredictable and corrupt ways, injecting a measure of uncertainty into economic incentives, property rights and government laws and regulations so as to discourage potential investors from being willing to put their capital at risk.

152. Whether and how Governments implement economic reforms will be influenced by the peculiarities of politics in each country. However, there are socio-political patterns common in much of sub-Saharan Africa that permit some broad generalizations about the politics of economic reform in the region. The majority of Africans are smallholder farmers producing food or cash crops, dispersed throughout the countryside and rarely organized or influential politically. This group is likely to benefit most from well-conceived economic reform programmes. Another group potentially benefiting from reforms are those efficient, competitive businessmen able to take advantage of new opportunities opened up by the reforms and not threatened by the loss of trade protection, subsidies, special access to foreign exchange or other arrangements likely to be eliminated by reform programmes. This group is extremely small in most African countries and so is seldom influential politically.

153. Those groups opposing reforms typically include middle-class Africans employed in the public sector whose incomes and employment are threatened by policies aimed at reducing government employment and expenditures or raising taxes. Student groups have also resisted reforms where they involve reductions in subsidies and the imposition of user fees. The two main groups demonstrating against stabilization measures imposed by the Government of Côte d'Ivoire over the past year or two have been civil servants and students, opposing decreases in their wages or levels of financial support respectively.

154. In a number of African countries - for example Kenya - larger farmers have also resisted particular reforms (e.g., the freeing up of restrictions on domestic food trade) threatening to eliminate lucrative rents accruing to them. Reductions in the size of the military threaten the interests of this powerful group in African societies - a group which has intervened often in African politics, at times in an effort to protect its corporate interests. Less visible are the patronage networks common in African politics which can also oppose reforms threatening to them. It is clear that the successive

failures of budgetary and fiscal reforms in Zaire were due in part to efforts by the Government to protect the access of its patrons to State resources.

(a) Impact on the poor

155. Inevitably, then, the burden of adjustment would tend to fall disproportionately on the politically weak and the poor. The adverse impact of economic reforms on the poor and on the distribution of incomes generally in developing countries has been of concern to the development community for some time. Two studies have been undertaken by World Bank staff on the impact of economic reforms in the first half of the 1980s on the poor in the Cote d'Ivoire. 14/ The most recent and detailed of these studies identifies a profile of poverty for the Côte d'Ivoire with the following groups, from the poorest to the least poor: food crop farmers; export croppers; informal sector households; formal private sector households; and government sector households. A calculation of the changes in per capita income (all groups experienced a decline) between 1980 and 1985 when the Government was implementing a variety of economic reform programmes, shows that the food producers (the poorest and the largest proportion of the population) have lost the most in real per capita income. Formal sector, government households were the second largest losers; producers of export crops suffered the smallest losses and informal sector households suffered the next lowest losses.

156. Another study on the impact of adjustment on the poor in Malawi 15/ found that structural adjustment had an adverse impact on the poor, mainly smallholder, agriculturalists and was not able to improve the supply response of those farmers. Both of these studies point to the impact of intervening factors in determining the social costs of adjustment on the poor and how important it is to take local conditions into account if those costs are to be eased.

157. A number of policies have been tried to mitigate the social costs of adjustment, including compensatory programmes (generous severance allowances, special credit programmes), temporary employment or relief for those losing their jobs, and increased subsidies generally for the poor. Development planners are reluctant to promote subsidy programmes because of the administrative burdens it can impose on Governments whose capacity is already strained by implementing reforms. A popular approach in Africa is for the Government to create public works and other programmes to provide additional employment to the poor and to unemployed civil servants. These programmes, however, are seldom large enough to be more than symbolic. Perhaps the best known one is the Programme to Mitigate the Social Costs of Adjustment (PAMSCAD) in Ghana.

158. Issues likely to be prominent in the political economy of reform in Africa during the 1990s include:

(a) Extending the scope of reforms to create a critical minimum necessary to stimulate private investment. Additional measures may be needed by external donors to encourage private investment where the economic environment is appropriate - for example, special training and credit programmes for local entrepreneurs;

(b) Promoting a reform success story on the African mainland to give greater visibility to the changes and the opportunities in the region and provide encouragement to other African countries with an example that reforms work;

(c) Shaping reform programmes to take better account of the impact of adjustment on the poor. The 1990s should bring much better information on what that impact has been in the past and will likely be in the future;

(d) Tailoring the scope, content and pace of reforms to take account of the challenges and opportunities growing out of political liberalization. It may be necessary for external institutions to accept more modest reform programmes in the period following political liberalization, as new and usually fragile regimes attempt to govern and to tackle their economic problems. Increased relief on public bilateral debt may also be appropriate for these countries;

(e) Ensuring that external financial support for reform programmes is adequate but not excessive. Conditions of that aid should be observed if African Governments are to take them seriously. Studies have shown that too much aid can weaken the incentives for implementing and maintaining reforms where Governments are reluctant to undertake reform programmes in any case;

(f) Recognizing that for some Governments, serious economic reforms may be impossible, either because of powerful domestic forces opposed to reform or because the Government is unwilling to implement reforms. In these cases, external aid agencies should not waste their time or money on supporting reforms.

(b) Impact on women

159. African women are a particularly vulnerable group in the face of declining real incomes and public sector supports, especially in low-income rural areas, because it is mainly up to them to find compensatory means to uphold family consumption and welfare. Normally, husbands and fathers transfer only part of their income to the family budget. When their income declines, they do not necessarily transfer higher proportions of it to the active household budget dispensed by women. This situation leads to a greater work burden and more severe time constraints imposed on women.

160. The above situation, in turn, has an adverse effect on women's production incentives, and this is especially so in peasant agriculture, because simultaneous increases in both food and cash-crop production are likely to increase the work burden of women and cash-crop income is likely to accrue to men. Women's rational reluctance to be redeployed to unremunerated work on export crops obviously weakens the efficacy of price incentives for export promotion. 16/

161. Although the argument is frequently made and accepted that security of tenure is required to encourage private investment in land, there has so far been little attention paid to the need for measures to ensure a more equitable gender division of leaseholds or of secure usufructuary rights. Moreover where women are household heads and simultaneously farmers or producer, legal or de facto discrimination against them in respect of access to credit or the

willingness of cooperatives and parastatals to accept produce directly from women would need to be eliminated in order to increase their productivity.

2. Asian socialist countries

162. Dissatisfaction with the rate of improvement on the standard of living was the primary reason for undertaking reforms in most of the socialist countries of Asia. Support for reform emerged within the socialist leadership of these countries, quite independently of the more recent economic and political upheavals in the formerly socialist countries of Eastern Europe and the former USSR. Due to differences in their stages of economic development, social structures and external economic relations, each of the reforming socialist countries in Asia pursued a somewhat different mix and sequence of policies.

163. Perhaps the earliest and most significant of the economic reforms in socialist countries began in China in 1978. 17/ In an effort to accelerate growth, the Government of China began a restructuring of its highly centralized economy with reforms in agriculture, devolving greater decision-making power to the peasants. These reforms, combined with good weather, produced a dramatic increase in agricultural productivity and production. Crop production grew at an annual average of 5 per cent between 1979 and 1984, compared to an annual average of 2.5 per cent for the period 1953-1978. The number of township and village industries increased eight-fold over the period 1978-1990, and the number of workers employed in them doubled. As a result, rural industry has become the most dynamic sector of the Chinese economy, and in 1990 accounted for roughly 25 per cent of industrial production and employment.

164. Other reforms followed those in agriculture, including a relaxation of direct planning controls, a decentralization of economic management from the centre to the regions, a greater reliance on market forces in setting prices, reforms in the labour market, banking, foreign trade, and property law, and permitting forms of ownership other than state ownership.

165. The impact of the reforms on economic performance since 1978 has been impressive. Gross domestic product rose by an average of over 9 per cent annually during the 1980s; non-residential fixed investment rose from 20 per cent of GNP in the early 1980s to about 26 per cent in 1989; the value in United States dollars of exports tripled in value over the decade, increasing foreign exchange earning essential to the import of machinery embodying more advanced technology; the average incomes of China's rural population doubled, some farm families became very well off; and absolute poverty decreased.

166. However, these economic gains were not without their costs. China experienced three cycles of inflation and adjustment during the 1980s. The most recent began in 1988, when high rates of inflation occasioned the imposition of deflationary policies by the Government. Many observers believe that if these economically disruptive cycles are to be avoided in the future, further reforms are necessary (e.g., hard budget constraints on public enterprises and increased liberalization of markets and prices) and a greater use of indirect policy instruments to influence the economy - for example, interest rates rather than centrally imposed credit ceilings.

167. Another major problem has arisen from the nature of China's economic reforms. The decentralization in economic decision-making to the provinces, including their power to tax and spend, has weakened the ability of Beijing to guide the economy and has even led to a degree of segmentation in the Chinese market as provinces attempt to promote and protect local industries.

168. The demands for political liberalization and the government repression at Tienanmen Square and afterwards appear initially to have dampened the open debates about economic change in China but are gathering momentum again. However, economic reform is very complicated, and the conceptual and managerial problems may have been more important obstacles than the resistance of entrenched interest groups. For example, the problem of price reform had to take into consideration inflationary pressure. State enterprises are subject to a higher rate of turnover tax than other enterprises, but most do not operate at a profit. Thus, increasing the autonomy of state enterprises has become more important as price reform progresses and is one of the most crucial tasks of further reform.

169. Similar reform measures were taken in 1986-1988 by Viet Nam and the Lao People's Democratic Republic in their initial packages, but they were far more extensive and drastic and their component measures came nearly simultaneously, unlike in China where they came more or less one by one. Price decontrol for farm products, the abolition of consumer subsidies for daily necessities and the devaluation of national currencies, including the adoption of uniform exchange rates, were among the key measures introduced. The preparation for the eventual privatization of over 3,000 state enterprises has already begun with the assistance of some foreign financial institutions.

170. In the Lao People's Democratic Republic, the new economic mechanism programmes, primarily aiming at the restructuring of state enterprises and their management, were installed on a trial basis in 1985-1986 and were expanded to cover the entire national economy in 1988. The programmes targeted price decontrol, enormous currency devaluation to market rates, the decentralization of authority to autonomous state enterprises, the instalment of a two-tier banking system dissolving the State Bank into a central and commercial bank, further monetization of the barter economy, the elimination of state monopoly over export and import, and the replacement of the old revenue system relying on state enterprise contributions by the new tax regime centred on corporate and individual income taxes, export taxes and business taxes. In March 1990 they also explicitly prohibited the role of all levels of government itself in production activities.

171. The economic impacts of these reform packages have invariably been impressive in the Asian socialist countries, increasing both agricultural productivity, farm household income and rural employment. In Viet Nam food production increased in 1989 and 1990, enabling it to export 160,000 tons of rice instead of importing 100,000 tons as in the past decade. The same has been true in the Lao People's Democratic Republic.

172. In Viet Nam the high rate of inflation, reaching over 600 per cent annually at the beginning of 1988, was brought down to 2.5 per cent per month in 1989 and 4.4 per cent in 1990. It is now estimated that one third of the autonomous state enterprises are making profits, unlike the past when all the state enterprises were accumulating losses. Vietnamese exports to the

convertible currency areas went up from US$ 728.2 million in 1988 to $2,200 million in 1990. As many as 290 foreign investment projects had been licensed by the second quarter of 1991, totalling in value $2 billion in contract terms and $5.0 billion in operational terms. There has been a rapid rise, particularly in and around Ho Chi Minh City, of small-scale domestic enterprises.

173. In the Lao People's Democratic Republic farm production also went up significantly over the reforming years, though unfortunately natural disasters and flooding all over the country reduced farm production in 1990-1991. Industrial production in the mining, manufacturing and public utilities sectors, however, increased by 13.6 per cent in 1990 and by 12 per cent in 1991. With exports of primary commodities, labour-intensive consumer goods and electricity rising over the past three years, the Lao current account deficit vis-à-vis the convertible currency area has declined from 22.1 per cent of GDP in 1989 to 6.8 per cent in 1990 and is expected to be down to 3.7 per cent of GDP in 1991.

3. Contrasts between Africa and the socialist countries of Asia

174. There are many contrasts between the economic reforms among the socialist countries of Asia and those in Africa. When the leadership in the former countries decided to undertake reform programmes, a political consensus with widespread popular support had already emerged, and authorities responsible for economic matters were able to design and implement the reforms themselves. Most reforms in Africa have been provoked by the need for foreign exchange and public revenue plus outside pressures and have been shaped or influenced by the international financial institutions.

175. The Chinese reform programme began with success. Reforms in agriculture called forth a major increase in production which then lent dynamism to rural industry. These successes, in turn, created a measure of support for the reforms among a large section of the Chinese population. Reforms in Africa have seldom produced such marked successes. Africans were unable to exploit opportunities for major increases in agricultural productivity (e.g., hampered by inadequate infrastructure), or the opportunities themselves were limited. It may have been that the Africans did not have the alternative of beginning their reform programmes in a sector where major gains were quickly possible.

176. Maintaining public support for reform in Asian socialist countries has most probably been easier than in many African countries and elsewhere, because it appears that the Asian socialist countries have been more successful at minimizing the costs of adjustment. In particular, the leadership in China was concerned from the beginning of the reform process that the benefits be widely shared.

4. Experience in other regions

(a) Lessons from Latin America

177. During the 1980s, nearly all of the countries in Latin America and the Caribbean were implementing adjustment programmes of varying intensity and

duration. For many, the catalyst was the immediate need to attend to major imbalances in their external accounts which resulted in the debt crisis beginning in 1982. As compared with other developing countries, Latin American countries exhibited much greater reliance on indebtedness as a response to a series of external shocks beginning in the mid 1970s.

178. Adjustment programmes in Latin America have included all of the features of the "consensus" described earlier. All made strenuous efforts to devalue their currencies in real terms in order to increase export earnings. Export volumes did increase, but supply elasticities were low in most countries. Moreover, for many, deteriorating terms of trade for primary commodities largely offset the improved performance of export volumes.

179. In a number of countries the currency depreciations used to improve profitability in export and import-substituting industries had perverse effects on public sector deficits. This is because they increased the local currency requirements of public sector external debt service, while the improvement in export earnings accrued to the private sector. Of course in countries where the public sector was a major owner in the export sector, as was true for oil exporters and some mineral exporters, public finances did improve simultaneously with improved export performance.

180. The legacy of interventionist policies was a relatively inelastic tax structure. Thus, when budget deficits could no longer be financed through direct or indirect recourse to external borrowing, the result was severe inflation or a sharp reduction in public expenditures or both, while Governments attempted to create a political consensus supportive of fiscal reform.

181. Results of these adjustment programmes cannot be readily disentangled from the effect of external shocks, but regional economic performance in the 1980s was extremely bad. During the decade, GDP per capita declined for the region as a whole, with 19 countries sharing in the declines. Among medium-sized countries, only Chile, which had been adjusting intensively throughout most of the 1970s as well as the 1980s, and Colombia, which had been cautious in its external borrowings, experienced positive growth for the decade. Macroeconomic imbalances, especially inflation, proved extremely difficult to reduce, and the number of people living in absolute poverty increased. Public investment fell sharply and per capita public expenditures on education and health fell in most countries of the region. Yet, without effective provision of health and education services, and physical infrastructure complementary to private sector investment, the supply response to improved incentives is likely to remain small.

182. One positive development in the political sphere was the re-emergence of participatory politics in nearly all countries which had been under authoritarian rule.

183. Among the lessons which may be learned from the Latin American experience are:

(a) The importance of a political consensus which will enable government to raise sufficient revenue through taxation and other non-inflationary sources to finance necessary developmental expenditures;

(b) The sensitivity of the costs of adjustment to the speed and intensity with which reforms are implemented;

(c) The importance of a proper sequence of reforms - in particular, the necessity of a phased and gradual process of financial market liberalization;

(d) The importance of the institutional situation in evaluating the likely costs and benefits of specific measures, such as trade liberalization;

(e) The importance of avoiding in so far as possible short-term measures which clearly reduce the capacity of the economy for sustained growth.

(b) Lessons from non-socialist Asia

184. The newly industrializing economies in Asia have had to adapt their policy regimes in response to strong domestic pressure for rising wages and to international pressure for a reduction in the trade surpluses of some of them. In the area of trade policies, import liberalization has made it possible for businesses to increase labour-intensive exports in areas outside the export processing zones. The need for public investment to reduce infrastructure bottlenecks has increased the need for tax revenues. These factors in combination have begun to shift the locus of demand towards the domestic sector with the effect of lowering profits in the export sector. There are of course the problems attendant upon the very success of the economic development strategies pursued by these countries.

185. Indeed, the successful industrialization drives of Taiwan Province of China and the Republic of Korea also helped to temper the enthusiasm of the Washington consensus participants for the power of purely liberal economic policies to promote growth-oriented adjustment. These cases confirmed that fiscal discipline and trade orientation are essential ingredients of successful adjustment efforts, but they also showed the importance of government not only for human development but also for its coordinating role in the areas of technological adaptation, provision of long-term finance, and in the design of a performance-oriented industrial policy.

186. The success of the newly industrialized economies has begun to benefit other countries in the region as well, not only because of the trade creating effects of their rapid growth but also because entrepreneurs have begun to relocate part of their production facilities for labour-intensive exports to other countries in the region.

187. Some countries in the region began reform in the agricultural sector in the 1960s - for example, India, which has reduced those living in poverty in rural areas. A number of countries in the region which had been pursuing primarily import-substitution policies (mainly in South Asia) have been experiencing internal pressure for an acceleration of growth. The outward orientation of the newly industrialized economies has become increasingly viewed with favour. One after another, countries have introduced export-promotion measures to offset the anti-export bias of their import substitution policies.

C. Shortcomings of current economic reform programmes

1. Lessons from country experiences

188. Major adjustment programmes in which stabilization is the first priority are often accompanied by a worsening of the income distribution and the numbers of people in absolute poverty. This may be because reforms are only put in place in the aftermath of considerable crisis and exacerbate an already unequal situation. This effect may prove to be transitory but also may last for several years. This was the case in Chile, which successfully pursued a policy of economic reform over nearly two decades.

189. In countries where reform involves improving the opportunities for the rural population and where they constitute a majority, reforms may quickly work to improve income distribution. In China reforms were initially more favourable for rural areas than for low-income urban residents. Reforms in some African countries may also work in this direction.

190. Impacts of adjustment programmes on the structure of government expenditures have also been substantial. In an attempt to determine how cuts in spending are distributed between different sectors in the economy, Hicks and Kubisch studied a sample of 37 instances of real reductions in government spending in 32 developing countries during the period 1972-1980. They found that, on average, spending on defence and social sectors was relatively well protected from budget cuts, while infrastructure investment and production were found to absorb disproportionately large reductions. 18/

191. In a more recent study focusing exclusively on the health sector, Abel-Smith brings out the great diversity that exists between countries. In a group of 13 Latin American countries, about half experienced a fall and the remainder a rise in real expenditures of the ministry of health. Similarly, the author found a great diversity among African countries, although the proportion of countries where expenditures fell was larger. Furthermore, in many countries, the size of the cutbacks was substantial. 19/

192. Pinstrup, Jaramillo, and Stewart corroborate certain of the results obtained by Hicks and Kubisch. Using data until 1984 they found, for instance, that defence spending again was most protected from government expenditure cuts and that investments expenditures were more heavily affected than current expenditures. They also argue, however, that looking at real levels of health expenditures rather than the share of government expenditures that is devoted to health (as did Hicks and Kubisch), the data show a tendency towards reduction in the early 1980s. 20/

193. Some of the economic lessons learned from adjustment programmes include:

(a) Correction of price distortions is not a sufficient policy measure if other obstacles to increase in supply are not addressed;

(b) A reform-induced increase in output from primary and informal-sector enterprises, even when it does occur, may not result in increased public revenue in the absence of tax reform;

(c) Measures thought to be required for short-term stabilization may give rise to high real interest rates and result in excessively volatile exchange rates and prices which discourage private investment;

(d) A prolonged and severe compression of domestic demand, if it accompanies a stabilization programme, will also depress investment;

(e) Political uncertainty may be increased if the initial stages of the reform process cause social unrest, and this will encourage investors to take a "wait-and-see" attitude;

(f) The Latin American experience has shown that the generation of trade surpluses, while necessary, is not a sufficient condition for Governments to be able to service the external debt of the public sector.

2. Other criticisms

194. Diverse criticisms have been made of adjustment programmes. One is that they are often over-ambitious, involving a broad array of measures to be introduced in a relatively short period of time and are expected to bring about near immediate results.

195. It has also been argued that insufficient attention is given to the need for measures to facilitate labour force adjustment - for example, by establishing job retraining programmes or employment services to assist in relocating workers.

196. Similarly, little concern has been given to the gender impacts of reductions in social services, such as education and health, or to the gender impact of land reform, including privatization, such as its effect on women's access to property.

3. Conflicting objectives

197. As has been alluded to earlier, conflicting objectives may create erroneous expectations as to the likely impact of certain policy measures. For example, it might be assumed that in a country exporting agricultural products, a devaluation, in addition to improving the balance of payments, will increase profits in the sector and induce an increase in supply. This depends on the assumption that producer prices will be increased in line with the devaluation. However, if commodity marketing boards intermediate between producers and the foreign importers, they may pass on only a small part of the gains to producers and use the rest to reduce the overall public-sector deficit.

198. Another example of conflicting objectives is with respect to the deregulation of financial markets. The intent may be to simply improve resource allocation. However, if short-term stabilization measures simultaneously result in high real interest rates, the effect may be to induce short-term capital inflows and a consequent exchange rate appreciation. This will, of course, work against increasing exports, normally an objective of both short- and medium-term adjustment programmes.

4. Problems with sequencing

199. Adjustment measures can all be announced in a single package, but there is the problem of the appropriate sequencing of reforms. The need for this type of sequencing seems to have been originally developed as a reaction to the failures of the so-called "open monetarist" experiments of the mid 1970s in the Southern Cone of Latin America and the so-called expansionary stabilization attempts in Argentina (austral plan), Brazil (cruzado plan) and Peru (inti plan) in the mid 1980s. In the first case, liberalization measures tended to precede fiscal adjustment, ending in major balance-of-payments crises. In the second case, wage-and-price controls proved to be inadequate substitutes for fiscal and monetary adjustment.

200. Thus the old virtues of fiscal discipline, monetary stringency, and undistorted pricing may not be sufficient, but they are indeed necessary ingredients of any sustainable stabilization attempt. Growth resumption is the final objective, but it cannot be reached until some critical intermediate steps are undertaken.

201. Structural adjustment programmes may also be highly complementary to long-term development strategies, since one of the aims of the latter is nearly always to increase the productivity of investment and thereby to increase the trend level rate of GDP growth.

202. Recent analysis by the World Bank of rates of return on over 1,500 investment projects provides impressive statistical support for the proposition that the quality of the overall policy framework can make a dramatic difference to the productivity of investment projects. Under an appropriate policy regime, the average economic rate of return can be as much as twice that of projects implemented under highly distorted policy regimes. This is large enough to suggest that economy-wide growth rates could be increased by as much as 2 per cent per year in the case of countries moving from highly distorted policy regimes to policy regimes with a low level of distortion. 21/

D. Reasons for failure to match expectations

1. Differences in initial conditions among countries

203. An important reason for failure to match expectations regarding the benefits of economic reform programmes is the differences in initial conditions among countries, some of which may have been the result of a prolonged period of inappropriate policies. The supply response to expenditure-switching policies in the short term depends upon the existence of slack capacity or, in the medium term, the ability to change product mix or increase capacity with relatively small, quick-yielding, investments. These conditions are likely to be met only when an economy is already highly diversified in respect of the range of its products, especially industrial ones, and/or in the extent of export diversification.

204. In the agricultural sector, production may be dominated by smallholder farming for which agricultural research and extension services may be in short supply, credit difficult to obtain and incentives dampened by patterns of land tenancy and the intrahousehold allocation of labour and income from cash crops.

205. In the manufacturing sector, the predominance of small private businesses means a high degree of specialization with a low degree of technological innovation and problems regarding access to credit and knowledge as to how to adapt products to the needs of international trade and how to penetrate markets.

2. Effects of the external economic environment

206. Of course neither short- and medium-term adjustment programmes nor long-term development strategies can hope to succeed fully without sustained growth of the world economy and favourable external conditions.

207. The prospect that real interest rates will remain high in the 1990s and the likelihood that official capital flows will grow only slowly underscores the need of collective efforts to revitalize economic growth and development, by reducing the cost of international finance to developing countries.

208. Long-term growth prospects depend on the continued expansion of international trade. Export-led growth needs expanding markets. The success of national domestic policies depends even more on the predictability, transparency and reliability of a given set of international rules for trading accepted and implemented by all trading partners. The uncertainty regarding those rules, given the present doubts over the final outcome of the Uruguay Round of multilateral trade negotiations, is an extra hurdle for countries implementing reforms of their trade policies.

209. In a scenario of low world economic growth, the prolonged weakness of commodity prices in real terms is likely to continue into the 1990s. Instability of export earnings is particularly difficult to absorb in poor and indebted countries. The design of stabilization and adjustment policies has to incorporate, through contingency arrangements, the possibility of large terms-of-trade shocks to individual countries resulting from volatility and decline in real primary commodity prices.

3. Management deficiencies in the administration of reform

210. The failure of adjustment programmes to achieve their intended results may have much to do with implementation. The sheer lack of enough well trained economic managers and technical personnel, particularly in the public sector, is often an important handicap, especially since reforms are needed in a number of areas simultaneously or over a short period of time.

211. The introduction of a deep public sector reform programme cannot wait for stabilization to be achieved. International cooperation in the form of sectoral adjustment loans, designed to support a thorough reform of the public sector has a crucial role to play.

E. Relation between economic reform and political reform

1. Political management of economic reform

212. Adjustment policies tend to be costly in political terms, subjecting local governments to a series of pressures. These pressures usually stem from at least three sources: beneficiaries of the previous status quo; transient bearers of the burdens of adjustment (output losses, sectoral unemployment, investment dislocations); and, of course, critics whose voice gains resonance with the time elapsed before results are recognized as beneficial. One reason for the early abandonment of policy reform may be that the government itself - or the majority coalition - is not convinced it is on the right economic policy track, being at best convinced that it has to display some discipline to enhance the "goodwill" of donors, creditors or international partners. This means that the fragility of domestic political support is one of the weakest points of most adjustment reforms. 22/

213. Another source of political resistance that may jeopardize success of the programme is a negative short-run impact on low-income groups. Radical policy moves tend to provoke serious sectoral dislocation of resources and employment and, for a period of time, may turn out to be politically unsustainable. Poverty levels and social indicators have to be explicitly considered as a constraint to enactment of policies; otherwise adjustment will at best be seen as a costly and, in many cases, unjustified way to gain access to foreign exchange.

214. It needs to be recognized that a wide gap exists between adjustment to a new set of international constraints in the case of an organized market economy and in the case of a developing economy after a decade of frustrated macroeconomic policies, low economic growth and worsening social conditions. Existing imbalances tend to reinforce and strengthen one another, as policy distortions pile up as a result of protracted adjustment. After a long period of artificial controls, not only may market distortions be the rule and rent-seeking opportunities develop profound roots in the institutional and social codes but their removal may require more than legislative changes and political will.

215. This is particularly dramatic when policy reforms take place in the wake of a major change in economic rules regarding property rights and the role of the State. In a significant number of sub-Saharan countries, the frustrated attempts after decolonization to build socialist economies on top of deep-rooted tribal customs have now been replaced by equally frustrated attempts to create capitalism overnight. There seemed to be a hope in some countries that the mere announcement of the new regime, with the support of international multilateral agencies, would bring in foreign capital. In the present situation, it is unlikely that voluntary investment will be forthcoming just because their Governments have managed to approve legislation welcoming foreign capital. This certainly does not mean that the legislation should not be passed, but political support for it should not be based on false hopes or else there will be no stability of the rules concerning private investment.

216. The conclusion is that the likelihood of a long delay between the adoption of a policy package and its political rewards needs to be taken into

consideration in choosing the strategy to carry out the programme. First, nothing is gained by making a government team accept a programme, the contents of which it does not believe in. Secondly, measures to prevent temporary negative effects of the programme for lower-income groups should be reckoned among the programme costs in order to prevent the emergence of a strong political coalition against the programme. Careful selection of policy measures, including some which discriminate in favour of the poor, can be used to foster the formation of political coalitions which will support the reform package as a whole. The need for a steady and consistent course of economic policy has, in the past, been used to justify authoritarian regimes which, it was claimed, provided a better environment for economic adjustment. If any conclusion may be drawn from the 1980s in this respect, it would be that dictatorships have not been able to provide an institutional ambience in which economic policy adjustment could be kept on a consistent path.

2. Political circumstances which facilitate successful reforms

217. Broad popular acceptance of the need for reform is a requirement for programme success in all but stable, autocratic regimes. It is self-evident that a highly autocratic and stable regime can implement successful reform if the programme is well conceived technically and viewed as necessary by the leadership. It is simplistic to believe, however, that democratic regimes of the multiparty parliamentary or presidential type are necessarily at a disadvantage in carrying out adjustment programmes. For one thing, an autocratic regime may, in fact, be crucially dependent on public opinion in key segments of the labour force. For another, the balance of power among factions within a single-party system may have to be taken into consideration and a widespread consensus developed, even though the process is less transparent than in an effective multiparty system.

3. Political circumstances which complicate economic reform

218. When an autocratic regime gives way to a democratic one, considerable time is likely to elapse before a coalition can be formed in support of an economic reform programme. It may also happen that the Government in a multiparty democracy may attempt to implement a reform programme without succeeding in mobilizing sufficient popular support. This may result in the programme being rejected in whole or in part by the national legislature and eventually lead to the fall of the Government. In some countries there are periods of frequent changes of government due to the inability of political parties to form a durable coalition. Under such circumstances, it is highly unlikely that any far-reaching adjustment programme can be successfully implemented.

219. Clearly, international institutions supporting the efforts of countries to implement adjustment programmes should endeavour to adapt the pace and intensity of the programme to the political constraints binding on governments. In particular, a concern for safeguarding or consolidating multiparty democratic political systems should be reflected in a more gradual approach, extending over a longer period of time than may be appropriate in other circumstances.

220. It is clear that an indispensable condition for the success, and therefore the sustainability, of economic reform is that it be accepted by the society undergoing it. The manner of ensuring - or facilitating - such political sustainability can be conceived of in different terms and, indeed, there are currently examples of highly varied approaches. Internally, efforts to ensure as much participation as possible within the country so as to have the reforms perceived as national goals involving many institutions - not just national Governments but also regional and local bodies, trade unions, professional associations, non-governmental organizations representing many different sectors, etc. - will help to sustain the political viability of economic reform through the initial period of difficult impact. Externally, foreign assistance can be used particularly to ease the difficulties of especially vulnerable parts of society to help the reforming Government maintain the credibility and support of its citizens.

221. To attempt to draw correlations between types of political organization and types of economic reform seems difficult, since "success" or "failure" will be measured by different criteria. Two points seem clear, however:

(a) Political systems which favour or at least enable those who will feel most strongly and negatively the impact of reforms to have a say in their conception, design and implementation (to allow for "fine tuning") will be more likely to sustain reform than those which do not;

(b) In so far as external assistance is frequently a component of the reform package, the fact that external lenders and donors are increasingly disposed to make such assistance conditional on political reform considerations has to be taken into account.

4. Human rights

222. The international community is giving increasing attention to human rights issues. For example, at the high-level meeting of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) in December 1990, its members reaffirmed "their conviction that there is a vital connection between open, democratic and accountable political systems, individual rights and the effective and equitable operation of economic systems with substantial reductions in poverty" and committed themselves to "work with their developing country partners to achieve more participatory development", mentioning explicitly, inter alia:

"- Enabling active participation of women in the processes of development as decision-makers, producers and providers of basic care;

"- Assisting developing countries in strengthening institutions, policies and practices leading to good government at central and local level;

"- Respect of human rights, including effective and accessible legal systems.

"- and asking for more detailed consideration of 'the operational implications of incorporating issues of participatory development into programme planning and management.'" 23/

223. This declaration reflects the growing concern over human rights issues among important constituencies for development assistance in the donor countries themselves and has led a number of donors to explicitly incorporate a human rights dimension in their aid policies.

224. A World Conference on Human Rights, scheduled for 1993, will focus international attention on a wide range of issues, including economic, social and cultural, civil and political rights.

225. The relationship between respect for human rights and the successful design and implementation of economic adjustment on reform programmes is complex. One problem is the difficulty of giving precise meaning to many of the enumerated "rights" found in international declarations. It is, for example, easier to define certain civil rights like "freedom from torture" than to define "right to education" or "right to development". Another problem is the degree of importance attached to an increase or a decrease in the enjoyment of different "rights". At one well understood extreme, Governments are willing to withhold foreign assistance and even to mobilize support for international sanctions when Governments violate certain civil rights - e.g. widespread and systematic use of torture. However, the operational concern for human rights in the design and implementation of economic programmes requires a different approach.

226. For this purpose, human rights might be grouped under three headings:

(a) Entitlements to an adequate share of national welfare - e.g., education, health, employment, training etc.;

(b) Individual freedom from governmental interference or abuse;

(c) Empowerment of people in the political process.

227. In the first group it is clear that reform programmes which explicitly attempt to safeguard human resource expenditures on, for example, education and health or which try to maintain the living standards of the poorest groups in society will have a better chance of achieving positive results in the medium and long term than those that do not, because people's capacity to produce will be enhanced. Such programmes may also enjoy greater public acceptability and, hence, have a greater chance of succeeding even in the short term.

228. In the second group of "rights", matters are less clear. Providing greater individual economic freedoms by deregulating some types of economic activity or reforming property relations, for example, by legal reforms giving women equal rights to own property and pledge collateral for loans are quite likely to increase the supply response of economic agents to other measures such as trade liberalization, devaluation etc. With respect to labour, reformers might fear that, greater freedom to organize could slow down the pace of reform because of resistance to the short-term reverses in income or employment or, on the other hand, recognition of the legitimate labour rights

would ensure inclusion of workers in the important deliberations regarding the nature of reform.

229. The types of rights involved in political empowerment, such as freedom of association, free expression, a free press, and freedom of public dissent, can also be factors contributing to successful implementation of reform programmes for the same reason open discussion could pave the way for consensus.

230. Human rights falling under all three of the above categories are desired in their own right, and the extent to which they are fully enjoyed in various countries is the subject-matter of a number of specialized forums and is not a matter in which the Committee for Development Planning has any special competence. However, there are some measures which have been urged in a human rights context which the Committee believes would clearly contribute to the successful implementation of economic reform programmes:

(a) Social safety nets, investments, and subsidies targeted on the poor should be viewed as a central component of fiscal and adjustment activities;

(b) International financial institutions as well as bilateral aid programmes should include tax policies and the pattern of public expenditures in the design of adjustment programmes with a view to ensuring progress in respect of poverty reduction and human resource development, even during periods of public-sector retrenchment;

(c) In this context the indicators described and analysed in Human Development Report 1991 - namely, the public expenditure ratio, the social allocation ratio, the social priority ratio, and the human expenditure ratio - are of special relevance. 24/

5. Nature of Governments 25/

231. The capacity of Governments to implement successful economic reform programmes has come under increasing scrutiny. The attention to governance tends to focus on actual decision-making relationships rather than on formal institutional structures and roles. It is not synonymous with multiparty democracies since these, as well as authoritarian regimes, or single-party States, can be badly governed.

232. While the institutional framework can vary enormously, some attributes of good governance can nonetheless be defined. These would include the following:

(a) Territorial and ethnocultural representation, mechanisms for conflict resolution and for peaceful regime change and institutional renewal;

(b) Checks on executive power, effective and informed legislatures, clear lines of accountability from political leaders on down through the bureaucracy;

(c) An open political system which encourages an active and vigilant civil society whose interests are represented within accountable government structures and which ensures that public offices are based on law and consent;

(d) An impartial system of law, criminal justice and public order which upholds fundamental civil and political rights, protects personal security, and provides a context of consistent, transparent rules for the transactions that are necessary to modern economic and social development;

(e) A professionally competent, capable and honest public service which operates within an accountable, rule-governed framework and in which the principles of merit and the public interest are paramount;

(f) The capacity to undertake sound fiscal planning, expenditure and economic management and a system of financial accountability and evaluation of public sector activities;

(g) Attention not only to central government institutions and processes but also to the attributes and capacities of subnational and local government authorities and to the issues of political devolution and administrative decentralization.

233. While the specific regional and country circumstances vary widely, there are a number of governance problems and challenges related to the above. These include:

(a) Artificial, usually post-colonial, state systems which are highly elite-centred, weak in relation to the external environment and the provision of socio-economic welfare, but at the same time autocratic and too heavy with oversized and inefficient executive, bureaucratic, military and security establishments;

(b) Weak or long-suppressed civil societies and systems of representation which have lacked the means effectively to hold political leaders and public officials to account;

(c) The subordination of legal, bureaucratic and other public institutions to the interests of ruling elites and the spread of non-accountable and corrupt practices throughout government;

(d) Excessive centralization and the lack of mechanisms for accommodating ethnic, cultural and sectional differences within heterogeneous societies which may have weak national but strong local identities;

(e) A sheer lack of skills, resources and knowledge relative to the demands of modern government and the exigencies of the international environment.

234. Donors (especially the former colonial Powers) bear some responsibility for the often parlous state of governance in developing countries. But to remedy that, donors should not assume that they have the answers in the form of some predetermined "blueprint" for political reforms and state restructuring. The basic values of good governance are cross-culturally valid, but to operationalize them requires intimate knowledge of local conditions, cultural contexts, existing organizational structures and patterns of interaction, and so on.

235. There is no consensus about the extent to which donors can act wisely in an area as sensitive and complex as the governance of other societies. None the less, there is an increasing demand, some of it coming from third world governments, for assistance in support of democratic transitions and institutional development and reform. Certainly issues of human rights and democratic government are now important elements in policy dialogues between countries. The best route for donors is to work cooperatively to strengthen the commitment and the capacity of developing countries themselves to undertake needed programmes of political restructuring. This will be more effective than any externally prescribed and imposed "conditionality". Developing countries could certainly benefit from concrete support for a wide variety of activities to achieve this political restructuring - for example, support for independent public policy research by their own social scientists; support for improvements in local administration through the strengthening of legislature and training of public servants and law officers.

236. Donors should not attempt to design or prescribe the actual system of politics and government to be followed by other societies. While Western experiences of democratic government can provide valuable lessons to be shared with developing countries, it is extremely important that projects for reforming institutions and processes of governance in these countries are indigenously based, grounded in locally generated knowledge, and that they engage public support and civic values within the countries themselves.

VI. IDENTIFICATION OF THE LEAST DEVELOPED AMONG THE DEVELOPING COUNTRIES

A. Criteria for identifying the least developed countries

237. During its twenty-seventh session the Committee formulated revised criteria for identifying least developed countries. These criteria, described in its report on that session, 26/ were discussed in the Second Committee of the General Assembly at its forty-sixth session. General Assembly resolution 46/206, entitled, "Report of the Committee for Development Planning: criteria for identifying the least developed countries", constituted a broad endorsement of the criteria formulated by the Committee.

238. The Committee was briefed by the Secretariat on the discussions which were held in the Economic and Social Council and the General Assembly regarding its recommendations and took note of General Assembly resolution 46/206. The Committee agreed on the need to consider further possible improvements in the criteria and their applications and requested the Secretariat to prepare a note on the subject for consideration at its thirtieth session (1994). The Committee also took note of the tables prepared by the Secretariat containing updated data on the least developed and other developing countries, pursuant to paragraph 257 of the report of the Committee on its twenty-seventh session.

B. Republic of the Marshall Islands and the Federated States of Micronesia

239. The Committee for Development Planning, during its twenty-eighth session, held in Kuwait City, 18-22 April 1992, considered the request of the Republic of the Marshall Islands and the Federated States of Micronesia for inclusion in the list of least developed countries.

240. The inclusion rule adopted by the Committee during its twenty-seventh session implies that a country will qualify for inclusion if:

(a) It meets all four formal criteria - namely, population size (75 million or less); income (per capita GDP of $600 or less as an annual average for 1986-1988, to be adjusted in the future for inflation in the developed market economies); a value of 47 or less on the augmented physical quality of life index (APQLI); and a value of 22 or less on the economic diversification index (EDI); or

(b) It meets the population and per capita income criteria and is below the cutoff points on either the APQLI or the EDI and is landlocked, is a small country with a population of 1 million or less, and suffers from frequent severe climatic risks such as droughts, floods and cyclones.

241. The Committee considered at length the economic and social situation of both countries and paid particular attention to the extremely high level of aid dependency, as measured by the ratio of official development assistance to GDP. According to the data provided to the Committee, per capita income in

both cases was substantially higher than the $600 threshold and the value of the APQLI exceeded the cutoff point for that indicator.

242. Consequently, the Committee decided not to recommend that the Republic of the Marshall Islands and the Federated States of Micronesia be included in the list of least developed countries at the time.

VII. WORK PROGRAMME FOR THE TWENTY-NINTH SESSION (1993)

243. The Committee agreed on the indicative two-year work programme outlined below and decided to prepare for its twenty-ninth session (New York, 19-23 April 1993) through three working groups, supported by relevant studies to be undertaken by the Secretariat and independent experts on the selected themes.

244. The Committee stressed the need for intensive substantive preparations before the regular session, including the work of consultants as well as the Secretariat and was informed by the Secretariat that its proposed work programme could be carried out within the current budgetary appropriations.

A. World economic outlook, 1993-2000

245. The Committee intends at its next session to conduct an analysis of trends and prospects for the world economy. The analysis will provide a context for its more detailed work on population growth and migration in relation to natural resources, environment and development. Special attention will be given to the globalization of markets for finance, foreign exchange, and labour and the constraints on autonomy in the conduct of national economic policies which it implies, and to other themes as may seem pertinent when it meets.

246. The Committee proposed to look into those and other related issues by convening a representative working group of from five to eight members and technical experts, chaired by Gerassimos Arsenis with Miguel Urrutia as rapporteur (Geneva, 28 September-2 October 1992).

B. Population growth and migration in relation to natural resources, environment and development

247. The Committee decided to examine the relationship of population growth and migration in relation to natural resources, environment and development. Particular emphasis will be placed on movements of people in relation to demographic pressure, civil strife, and relative economic performance in the countries of origin compared to countries of destination as well as the impact of immigrants on the economies of the countries in which they settle. It is hoped that the Committee's work on this topic will contribute to its consideration by the Economic and Social Council in 1993, for which it had been selected as one of the major policy themes, and to the International Conference on Population in 1994.

248. The Committee proposed to look into these and other related issues by convening a representative working group of from five to eight members and technical experts, chaired by Solita Monsod, with Helen Hughes as rapporteur (Geneva, February 1993).

C. Working group on technical assistance in the context of the role of the United Nations in international economic cooperation

249. The Committee decided to examine the contribution of the technical assistance activities of the United Nations system to the economic development of developing countries and countries with economies in transition. Among other issues, it proposed to consider the relationship of these activities to those carried out by international organizations and on a bilateral basis; it would also consider the relative importance of technical assistance in the context of the broader role of the United Nations in international economic cooperation; in addition, it would explore ways in which the Committee itself could contribute to enhancing the effectiveness of the technical assistance activities of the Department for Economic and Social Development. The Committee proposed to look into these and other related matters by convening a representative working group of from five to eight members and technical experts, chaired by Akilagpa Sawyerr, with Just Faaland as rapporteur (New York, October 1992).

VIII. ORGANIZATION OF THE SESSION

250. The twenty-eighth session of the Committee for Development Planning was held at the Arab Fund for Economic and Social Development in Kuwait City from 18 to 22 April 1992. Seventeen members of the Committee attended: Abdlatif AL-HAMAD, Gerassimos ARSENIS, P. N. DHAR, Just FAALAND, Tchaboure GOGUE, Keith GRIFFIN, Patrick GUILLAUMONT, Helen HUGHES, Nicolai LIVENTSEV, Solita MONSOD, Henry NAU, Maureen O'NEIL, T. Ademola OYEJIDE, PU Shan, Akilagpa SAWYERR, Miguel URRUTIA, Ferdinand VAN DAM. Goran OHLIN attended as a co-opted expert. Seven members were unable to attend: Karel DYBA, Ryokichi HIRONO, Udo Ernst SIMONIS, George SURANYI, Mahbub UL HAQ, Edmar BACHA, Ricardo FFRENCH-DAVIS.

251. The officers elected at the twenty-sixth session for the term ending on 31 December 1991 were:

Chairman: Abdlatif Y. AL-HAMAD

Vice-Chairmen: Edmar BACHA
Just FAALAND
T. Ademola OYEJIDE

Rapporteur: Keith GRIFFIN

252. The session was opened by its Chairman, Abdlatif Y. AL-HAMAD, who expressed his pleasure that the Committee members had accepted the invitation of the Government of Kuwait and the Arab Fund for Economic and Social Development to meet in Kuwait. Their presence reflected the rapid return to normalcy of his country which augured well for the future. A statement by the Under-Secretary-General, Department of Economic and Social Development, Mr. JI Chaozhu, was read. In it, Mr. JI assured the members of the Committee that the recent reorganization of the Secretariat would enhance its capacity to service the Committee. He looked forward to the outcome of the Committee's deliberations on the role of the United Nations system in enhancing international cooperation for development which he viewed as an important contribution to the discussion on that theme in the high-level segment of the Economic and Social Council at its 1992 meeting. He went on to note the relevance of the Committee's deliberations on the medium-term prospects of the world economy to the Declaration on International Economic Cooperation, in Particular the Revitalization of Economic Growth and Development of the Developing Countries, which was adopted at the eighteenth special session of the General Assembly, and the International Development Strategy for the Fourth United Nations Development Decade and to the review of their implementation, which was on the agenda of the forty-sixth session of the General Assembly (1992). He said that the principal issue with respect to reform in developing countries was the need to reconcile macroeconomic adjustment with structural reform while making progress in accelerating economic growth and alleviating poverty. Finally in view of the dual role of the Department in servicing the deliberative activities of intergovernmental bodies and providing technical assistance, he invited the Committee to provide its views on ways by which the operational activities of the United Nations could be strengthened and made more effective. He expressed the hope that the Committee's analysis and policy recommendations on the linkages between

poverty, growth and the environment would be of assistance to the Council in the follow-up activities on Agenda 21 after the completion of the United Nations Conference on Environment and Development.

253. At the conclusion of the session, the Committee members expressed their appreciation to the Arab Fund for Economic and Social Development for having arranged the holding of its twenty-eighth session in Kuwait City.

254. Preparation for the session had been carried out by three working groups of the Committee. The working group on the world economic outlook, 1992-2000 (Geneva, 5-7 February 1992) consisted of Nicolai LIVENTSEV (Chairman), Helen HUGHES (Rapporteur), Ferdinand VAN DAM and co-opted experts Sheila PAGE and Peter PAULY. The working group on economic reform in developing countries (New York, 19-22 November 1991) consisted of Ademola OYEJIDE (Chairman), Maureen O'NEIL (Rapporteur), P. N. DHAR, Ricardo FFRENCH-DAVIS, Patrick GUILLAUMONT, Tchaboure GOGUE, Solita MONSOD and PU Shan. The working group on poverty, environment and development (Geneva, 8-11 October 1991) consisted of Udo SIMONIS (Chairman), Miguel URRUTIA (Rapporteur), Gerassimos ARSENIS, Just FAALAND and Akilagpa SAWYERR.

255. Substantive services for the session were provided by the Department of Economic and Social Development. The following bodies were represented at the session: United Nations Development Programme, United Nations Economic Commission for Africa, United Nations Economic and Social Commission for Western Asia, United Nations Environment Programme, Food and Agricultural Organization of the United Nations, United Nations Fund for Population Activities, International Fund for Agricultural Development, the United Nations Educational, Scientific and Cultural Organization.

Notes

1/ Official Records of the Economic and Social Council, 1991, Supplement No. 11 (E/1991/32), chap. II.

2/ United Nations Department of Economic and Social Development, "World economic situation and prospects, 1991-1996: report on the meeting of the Expert Group on Short- and Medium-term Projections of the World Economy (Project Link)". Occasional Paper No. 8.

3/ "Poverty, environment and development: report of Working Group 3 of the Committee for Development Planning". Mimeo.

4/ Official Records of the Economic and Social Council, 1990, Supplement No. 7 (E/1990/27), chap. I., paras. 25 and 26.

5/ Ibid., Supplement No. 6 (E/1988/16), para. 97.

6/ Ibid., paras. 109, 110, 112-113.

7/ This section draws heavily on Carol Lancaster, "The political economy of reform in developing countries, with special reference to Sub-Saharan Africa". 1991. Mimeo.

8/ See, for example, World Bank, Adjustment Lending: An Evaluation of Ten Years of Experience. Policy and Research Series No. 1 (Washington, D.C., 1988); Africa's Adjustment and Growth in the 1980s, Prepared with UNDP (Washington, D.C., 1989); Adjustment Lending Policies for Sustainable Growth, Policy and Research Series No. 14 (Washington D.C., 1990); and Special Program of Assistance: Growth, Aid and Debt, Africa Region (Washington, D.C., 1990).

9/ Justin Zulu and Saleh Nsouli, Adjustment Programs in Africa: The Recent Experience. Occasional Paper No. 34, (Washington, D.C., International Monetary Fund, 1985).

10/ World Bank, Africa's Adjustment and Growth in the 1980s (Washington, D.C., 1989), p. 3.

11/ Economic Commission for Africa, African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (Addis Ababa, 1989).

12/ See, for example, International Food Policy Research Institute, Policy Brief No. 5, "Structural change in African agriculture" (February 1990). See also Simon Commander, ed., Structural Adjustment and Agriculture (London, James Currey, 1989).

13/ See, for example, World Bank, Sub-Saharan Africa: From Crisis to Sustainable Growth (Washington, D.C.), p. 60. See also Pierre Landell Mills and Ismail Serageldin "Governance and the external factor", paper for World Bank Annual Conference on Development Economics, 1991.

14/ See Paul Glewwe and Dennis de Tray, The Poor During Adjustment: A Case Study of Côte d'Ivoire. World Bank Living Standards Measurement Study, Working Paper No. 47 (Washington, D.C., 1988); and Ravi Kanbur, Poverty and the Social Dimensions of Structural Adjustment in Côte d'Ivoire, Social Dimensions of Adjustment in Sub-Saharan Africa Policy Analysis (Washington, D.C., World Bank, 1990).

15/ Uma Lele, Structural Adjustment, Agricultural Development and the Poor: Lessons from the Malawian Experience, World Bank, MADIA Discussion Paper No. 6 (Washington, D.C. 1989).

16/ In Mali, for example, women refused to grind the increase in men's maize output because they realized no return and had to give up some self-provisioning work to do it.

17/ The material in this section is drawn from the following works: Mario Blejer, David Burton, Steven Dunaway and Gyorgy Szapary, China: Economic Reform and Macroeconomic Management. IMF Occasional Paper No. 76 (Washington, D.C., 1990); World Bank, China: Between Plan and Market (Washington, D.C., 1990); Harry Harding, "The problematic future of China's economic reforms" in China's Dilemmas in the 1990s: The Problems of Reform, Modernization and Interdependence, Richard Kaufman and John Hardt, eds., Joint Economic Committee of the United States Congress (Washington, D.C., 1991); Kang Chen, Gary Jefferson and Inderjit Singh, "Lessons from China's economic

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Annex I

AGENDA

1. Adoption of the agenda and other organizational matters.

2. Discussion of the report of working group 1 on the world economic outlook, 1992-2000.

3. Discussion of the report of working group 2 on economic reform in developing countries.

4. Discussion of the report of working group 3 on poverty, environment and development.

5. Discussion of the major theme of the high-level segment of the Economic and Social Council of 1992: "Enhancing international cooperation for development: the role of the United Nations system".

6. Identification of the least developed among the developing countries.

7. Other matters.

8. Arrangements for future work.

9. Adoption of the report of the Committee on its twenty-eighth session.

Annex II

LIST OF THE LEAST DEVELOPED AMONG THE DEVELOPING COUNTRIES

	Country	Date of inclusion on the list
1.	Afghanistan	1971
2.	Benin	"
3.	Bhutan	"
4.	Botswana	"
5.	Burkina Faso	"
6.	Burundi	"
7.	Chad	"
8.	Ethiopia	"
9.	Guinea	"
10.	Haiti	"
11.	Lao People's Democratic Republic	"
12.	Lesotho	"
13.	Malawi	"
14.	Maldives	"
15.	Mali	"
16.	Nepal	"
17.	Niger	"
18.	Rwanda	"
19.	Samoa	"
20.	Somalia	"
21.	Sudan	"
22.	Uganda	"
23.	United Republic of Tanzania	"

Country	Date of inclusion on the list
24. Yemen	1971
25. Bangladesh	1975
26. Central African Republic	"
27. Gambia	"
28. Cape Verde	1977
29. Comoros	"
30. Guinea-Bissau	1981
31. Djibouti	1982
32. Equatorial Guinea	"
33. Sao Tome and Principe	"
34. Sierra Leone	"
35. Togo	"
36. Vanuatu	1985
37. Tuvalu	1986
38. Kiribati	"
39. Mauritania	"
40. Myanmar	1987
41. Mozambique	1988
42. Liberia	1990
43. Cambodia	1991
44. Madagascar	"
45. Solomon Islands	"
46. Zaire	"
47. Zambia	"